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APPENDIX TO PETITIONER'S BRIEF

IN THE

United States Court of Appeals

FOR THE FOURTH CIRCUIT

No. 7391

SOUTH CAROLINA GENERATING COMPANY,
Petitioner,

VERSUS

FEDERAL POWER COMMISSION and
GEORGIA PUBLIC SERVICE COMMISSION,
Respondents.

No. 7393

SOUTH CAROLINA PUBLIC SERVICE COMMISSION,
Petitioner,

VERSUS

FEDERAL POWER COMMISSION and
GEORGIA PUBLIC SERVICE COMMISSION,
Respondents.

ON PETITIONS FOR REVIEW OF AN ORDER
OF THE FEDERAL POWER COMMISSION

Petitioners' Appendix
Part I

THE STATE CONSTITUTIONAL PRINTING CO.

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PETITION FOR REVIEW

To the Honorable the United States Court of Appeals for the Fourth Circuit:

The South Carolina Generating Company (the Generating Company), created under the laws of South Carolina and engaged in business solely in that State, being aggrieved by the Order of the Federal Power Commission, issued October 24, 1956 (Opinion No. 297, Docket E-6585) and by the Commission's Order of December 20, 1956 denying petitions for rehearing, hereby petitions this Court to review these Orders of the Commission and in support of this petition would respectfully show:

I

JURISDICTION

The jurisdiction of this Court is invoked under §313 (b) of the Federal Power Act (16 U.S.C.A. §825 L). The order of the Commission was filed on October 24, 1956. A timely

petition for rehearing was filed by the Generating Company. This petition was denied by the Commission's Order of December 20, 1956.

II

THE HISTORY OF THE PROCEEDINGS BEFORE THE COMMISSION

The Federal Power Commission under date of October 27, 1954 adopted an Order directing the Generating Company to make a showing of facts necessary to permit the Commission to determine whether the Generating Company's rates and charges to Georgia Power Company (Georgia Power) under a contract dated November 9, 1951 were unduly discriminatory, unjust or unreasonable. The Georgia Public Service Commission and the South Carolina Public Service Commission were permitted to participate in the hearings.

The testimony was taken before a hearing Examiner. After all the testimony had been completed and the issues had been exhaustively briefed the Examiner filed his Decision on February 29, 1956 in which he found that the Generating Company's rates and charges to Georgia Power were not unduly discriminatory, unjust or unreasonable. The Examiner ordered, subject to review by the Commission, that the investigation be terminated and the proceeding dismissed.

The staff of the Federal Power Commission and the Georgia Public Service Commission filed exceptions to this Decision. Oral argument on these exceptions was had on May 10, 1956 before three of the members of the Commission, two of whom participated in the decision. The Commission under date of October 24, 1956 reversed the Examiner's initial decision, found the rates and charges unjust and unreasonably high, and ordered the Generating Company to file a new rate schedule which would (a) effect a reduction in charges for the year 1956 and annually thereafter totalling some $252,186.00 per year, (b) eliminate from the contract certain escalator provisions and (c) modify other clauses of the contract. The Commission did not find undue discrimination.

After the denial of the Petition for Rehearing on December 20, 1956, this Petition for Review followed.

III

THE CONTRACT IN ISSUE

The contract of November 9, 1951 provides that the Generating Company will sell and Georgia Power will buy over a 25 year period electric energy up to a maximum demand of 75,000 KW generated at Generating Company's "Urquhart Plant" located on the South Carolina side of the Savannah River and transmitted over 115 KV line to an interconnection with Georgia Power at the state line. The contract contemplates that Georgia Power is entitled to a maximum of one-half of the output of each of the first two 75,000 KW generating units installed at Urquhart. The billing to Georgia is under a two-part capacity and energy type rate. This means that a charge is made for the maximum energy that Georgia Power would be entitled to take at any one time (since the investment in facilities must be made and maintained in order to enable the utility to provide the capacity for meeting that demand whenever the customer wishes), and a different charge is made for the amount of energy actually taken in any period, since operating expenses must be paid in order to produce that energy. It is the capacity component which is at issue here. The contract contains provisions permitting the Generating Company to cancel or to reduce deliveries after stated notice periods.

This is the only contract of the Generating Company subject to the jurisdiction of the Federal Power Commission.

IV

THE PARTIES AND THEIR POSITIONS

The Generating Company was organized in 1951. It is a wholly owned subsidiary of South Carolina Electric and Gas Company (Electric and Gas), which is also a South Carolina corporation engaged in the generation, transmission and distribution of electric energy in South Carolina. All of the properties of both corporations (with the exception of a part of a hydro-plant on the Savannah River) are located and their principal place of business is in South Carolina and neither operates elsewhere. Both are subject

to the regulatory jurisdiction of the South Carolina Public Service Commission.

Georgia Power is an electrical utility operating entirely in the State of Georgia. It has no corporate or financial connection of any kind with the Generating Company or with its parent, Electric and Gas. It is subject to regulation by the Georgia Public Service Commission. It was not a party to the proceedings before the Federal Power Commission but, through the testimony of its President, it supported the validity of the contract and the reasonableness of the charges under it.

In the proceeding before the Commission the South Carolina Public Service Commission supported the position of the Generating Company.

The Georgia Public Service Commission took the position that the rates and charges in the contract were unduly discrimnatory, unjust and unreasonable. That position was also taken by those members of the staff of the Federal Power Commission who participated in the hearing. The Commission's order adopts the staff position that the rates and charges were unreasonably high to the extent of $252,186.00 annually.

V

THE MATERIAL FACTS

In November 1950 when the United States announced that it would construct a large hydrogen bomb plant near the Savannah River in that portion of South Carolina served by Electric and Gas, that company negotiated with the AEC and with duPont, who acted as agent of AEC for suppiying its electric requirements. The only way the needs of AEC could be met satisfactorily was by utilizing the entire resources of the system to finance a specially organized generating subsidiary, whose debt ratio would be higher than an independent company could possibly market and higher than was permitted to the parent itself under the restrictions of its existing mortgage. Since purchasers of securities of the parent would appraise the enterprise on a consolidated basis, the parent would be required, after financing the subsidiary, to raise increasing proportions of its new capital requirements through equity securities, at correspondingly

increased costs. But the public desirability of meeting the needs of AEC make it desirable to go ahead with the arrangement.

Georgia Power, learning of this arrangement and being in need of additional power itself, entered into negotiations in 1951 for service from the new Generating Company. After an arms' length trade, where each party had the benefit of expert advice on the cost of equivalent energy to Georgia Power through its own construction and from other sources, the contract herein in issue was made. Under it Georgia Power obtains 75,000 KW of energy at a charge of $600,000 less each year than it could have obtained it elsewhere. Its officers consider that it made a good trade in 1951 and that the contract is still a good contract for Georgia Power and for its customers.

The ability to finance the construction of the Urquhart plant by the Generating Company was only possible because of the credit of the parent company and of burdensome commitments by the parent. In addition to these obligations which it assumed, the parent was required by the high debt ratio of the Generating Company to finance its own expansion during the years when Urquhart was being built (1951-1954) with more expensive equity money. Seventy-two per cent (72%) of the parent's new money during these years came from common stock equity. Therefore, to determine the reasonableness of the rates and charges in the Georgia contract the Commission and the Court should look at its effect on the Electric and Gas system by which the service was provided, not merely to the cost of this energy, as separately computed, to the Generating Company, which was only the immediate instrumentality.

VI

POINTS TO BE RELIED UPON

The points urged in support of this Petition for Review are those included in the Petition for Rehearing filed with the Federal Power Commission. They may be thus summarized.

1. Where two unaffiliated electric utilities, bargaining at arms length and neither being under any legal obligation

to buy from or to sell to the other, reach an agreement for the sale and purchase of 75,000 KW of electrical energy over a twenty-five (25) year period, on terms and conditions of benefit to both, the resulting contract is not subject to modification by the Federal Power Commission in the absence of a showing that the rates and charges to the Purchaser are so high as to impair its financial ability to continue its public service or so high as to cast upon its customers an excessive burden. Since the undisputed testimony before the Commission shows that the effect of this contract is to save Georgia Power six hundred thousand ($600,000.00) dollars annually there can be no such showing.

2. Where two unaffiliated electric operating utilties serving adjacent territories enter into a mutually beneficial contract, fairly negotiated, providing for joint participation in building and operating additional generating facilities which results in substantial economies to each, the Federal Power Commission can not substantially alter the contract merely because the rates and charges may not fit into a "cost to serve" formula.

3. If the issue of reasonableness of the rates and charges to Georgia Power under this contract were to be tested by a "cost to serve" formula the Commission should have determined the realistic cost to the entire Electric and Gas system to serve this contract rather than the technical cost to its wholly owned subsidiary, the Generating Company. As shown above, this was only part of the whole. Since, by the Commission's own finding, the consolidated capitalization ratios must be taken into account to determine the real cost of the generation, by the same token the consolidated tax deductions must equally be taken into account, since they are merely a consequence of capitalization. When the Commission looked only at the subsidiary's taxes separately computed and ignored the consolidated taxes, which were the only realistic measure, its action was arbitrary and without warrant in law.

4. There is no substantial evidence justifying the decision of the Federal Power Commission that the rates and charges under the contract between the Generating Company and the Georgia Power Company were unjust or unreasonable.

5. Under the applicable provisions of the Federal Power Act, the Commission may not fix just and reasonable rates until it has first reached a determination, based on substantial evidence, that the contract rates are unreasonable and unjust.

6. Since the parties to the contract had agreed upon automatic adjustment in plant investment and expenses and such agreement does not violate any provision of law it was arbitrary and beyond the power of the Commission to strike these parts of the contract, the effect of which will unnecessarily burden the parties and the Commission with requests for rate order modification and, because of "regulatory lag", prejudice the Generating Company.

7. Where a hearing Examiner has taken the testimony, heard all the testimony and made his initial decision with detailed findings on the basis of the great preponderance of the evidence it is not sound administrative procedure for the Commission, when no Commissioner has heard any of the evidence and only two have heard oral arguments to summarily discard the entire initial decision and file its own opinion and order contrary to the great weight of the evidence. The action of the Commission here is arbitrary and beyond its power.

8. The action of the Commission is further arbitrary and void for all of the reasons stated in the petition for rehearing, a copy of which will be filed herein and is incorporated by this reference.

VII

PETITION FOR STAY

9. On November 7, 1956, Generating Company petitioned the Commission to Stay the effect of its order reducing the rates and charges involved pending final disposition of the matter by the Commission. Pursuant to this petition, the Commission issued its order on November 16, 1956, staying the effect of the newly prescribed rates for a period extending 60 days after final action by the Commission, provided the Generating Company filed with the Commission an agreement by the Generating Company to receive payments, subject to its obligation to refund, with interest, the excess

over and above the prescribed rates and to keep accurate accounts, in connection therewith, and to establish a reserve therefor. Generating Company accepted these conditions by its "Acceptance of Order Granting Stay" dated the 21st day of November, 1956.

10. Should the rates and charges prescribed by Respondent's Opinion No. 297 be made effective and this Honorable Court subsequently sustains the prayer of this "Petition for Review" thus necessitating retroactive billing and computations for which no procedure is presently provided, a great burden and unnecessary cost and expense will be cast on the Generating Company and on Georgia Power, all of which will be against the public interest, whereas if the rates presently in effect are maintained until such time as the matter is ultimately adjudicated there will be no such added burden, while the Court would preserve, as did the Commission, full power to carry out the decision of the Commission if it should be confirmed, without loss or injury to Georgia Power.

WHEREFORE, The Petitioner prays that this Court review the order of October 24, 1956 and the order of December 20, 1956 denying a rehearing and enter an order setting them aside in whole and enjoining their enforcement [see 16 U.S.C.A. §825 L.(b)]. In addition, Petitioner prays, pursuant to 16 U. S. C. A. §315 (c), that the Court enter an order staying the Commission's order of October 24, 1956, until thirty days after this Court shall have entered its final judgment herein.

T. JUSTIN MOORE,
Richmond, Virginia
ARTHUR M. WILLIAMS, JR.,
W. C. MCLAIN,

February, 1957

DAVID W. ROBINSON,
Columbia, South Carolina
Attorneys for the Petitioner,
South Carolina Generating Company

IN THE

United States Court of Appeals

FOR THE FOURTH CIRCUIT

No. 7393

SOUTH CAROLINA PUBLIC SERVICE COMMISSION,
Petitioner,

VERSUS

FEDERAL POWER COMMISSION and
GEORGIA PUBLIC SERVICE COMMISSION,
Respondents.

PETITION FOR REVIEW

To the Honorable the United States Court of Appeals for the Fourth Circuit:

Now comes the South Carolina Public Service Commission, an agency of the State of South Carolina, and petitions this Court to review the Order of the Federal Power Commission issued October 24, 1956 (Opinion No. 297, Docket E-6585) and its Order of December 20, 1956 denying petitions for rehearing since the South Carolina Public Service Commission is aggrieved by these orders within the meaning of Section 313 (b) of the Federal Power Act.

I

The Federal Power Commission by its Order of October 24, 1956 reduced the rates and charges made by the South Carolina Generating Company (Generating Company) to

the Georgia Power Company (Georgia Power) under the contract between these parties dated November 9, 1951 by the sum of $252,186 annually and struck from the contract escalator clauses which permitted the modification of charges without the necessity of regulatory action.

The Generating Company and its parent company, the South Carolina Electric and Gas Company, are South Carolina corporations and operate only in that state. As electric, gas and transportation utilities they are subject to the regulation of the South Carolina Public Service Commission. The jurisdiction and regulatory authority of the Federal Power Commission extend only to this one contract.

The effect of the action of the Federal Power Commission in altering the contract between the Generating Company and Georgia Power is to invade the regulatory jurisdiction of the South Carolina Public Service Commission and to impair its ability to regulate this electric utility whose business is essentially intrastate in violation of the spirit of the Constitution of the United States and of the Federal Power Act.

II

The contract between the Generating Company and Georgia Power was a fairly negotiated agreement under which two independent operating electric utilities serving contiguous territory, neither with any public service obligation to the other, entered into a contract for the joint use of generation facilities which resulted in substantial economies to both and benefited the customers of each. It should not be altered by the Federal Power Commission merely because it does not fit a "cost to serve" formula.

III

Since the operations of the South Carolina Electric and Gas Company are wholly within the State of South Carolina the question of the creation of this subsidiary (Generating Company) in order to finance and build an electric generating plant on terms which permitted serving the needs of AEC was submitted to the South Carolina Public Service Commission. Later, Generating Company's financing and its con-

tract with Georgia Power were examined and carefully studied to make sure that they served the public interest. Only when this Commission was satisfied that they did were the plans approved. The rates and charges included in the contract between Generating Company and Georgia Power were an essential part of the plan. The reduction of those charges as contemplated in the Order of October 24, 1956 and the revision of the escalator clauses will have a harmful effect upon the public interest, particularly the customers of the South Carolina Electric and Gas system who will have to bear the burden of this reduction to Georgia Power. The Federal Power Act was intended to supplement, not supersede state regulatory jurisdiction. The action of the Power Commission here disregards the jurisdiction of your Petitioner and should be set aside by this Court.

IV

The action of the Federal Power Commission here will have the effect of discouraging neighboring utilities from cooperating in the building and use of electric generating plants and the free flow of electric energy over interconnected transmission lines and therefore will prejudice the public interest which the Federal Power Act was intended to benefit.

V

The Order of October 24, 1956 casts doubt upon the power of the Generating Company to exercise its contract right to terminate this sale upon the notice contemplated in the agreement. This provision in the contract was a major factor in securing the approval of this Commission to the sale of this large block of power for use outside the state. The protection of the electric rate payers in South Carolina requires that this power be used in South Carolina when economic conditions require. The decision as to when that time will arrive is for the Generating Company under the terms of the contract, subject to the general regulatory supervision of the South Carolina Public Service Commission and not for decision by the Federal Power Commission as indicated in Opinion No. 297.

VI

The record shows that the sale to Georgia Power was, in reality, made by the South Carolina Electric and Gas Company and in determining whether the charges are unreasonably high it was the duty of the Federal Power Commission to consider the impact of the contract on the entire system, which that Commission refused to do on the important matter of Federal income taxes.

VII

Clauses in long term power contracts which escalate charges with rising and falling prices permit prompt and necessary adjustments without the burdens and delays of regulatory proceedings. Such clauses are legal and appropriate subjects for consideration by buyer and seller. It was arbitrary for the Federal Power Commission to strike such clauses from the contract in issue here.

WHEREFORE, the Petitioner prays that the Court review the Order of October 24, 1956 and the Order of December 20, 1956 and enter its order setting aside and enjoining the enforcement of these Commission orders.

Respectfully submitted,

T. C. CALLISON,
Attorney General
for the State of South Carolina

IRVINE F. BELSER,
Assistant Attorney General
for the State of South Carolina and
General Counsel for the South Carolina Public Service Commission
Attorneys for Petitioner.

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Jerome K. Kuykendall, Chairman; Claude L. Draper, Nelson Lee Smith, Seaborn L. Digby and Frederick Stueck.

In the Matter of
South Carolina Generating Company } Docket No. E-6585

ORDER INITIATING PROCEEDING

South Carolina Generating Company (Generating Company), incorporated under the laws of the State of South Carolina, with its principal place of business at Columbia, South Carolina, by letter dated July 24, 1953, tendered for filing as its FPC Rate Schedule an agreement dated November 9, 1951,[1] providing for the supply of a portion of the energy requirements of the Georgia Power Company (Georgia Company), at up to a maximum demand of 75,000 kw. Generating Company, a wholly-owned subsidiary of South Carolina Electric and Gas Company (South Carolina Company) included as a part of that filing a copy of another contract dated November 9, 1951,[2] pursuant to which Generating Company agreed to supply a portion of the energy requirements of its parent at up to a maximum demand of 75,000 kw.

In both instances the energy supplied is to be generated at Generating Company's Urquhart steam electric generating station located near Beech Island, South Carolina, with delivery to South Carolina Company at 115 kv at Generating Company's Urquhart substation and delivery to Georgia Company a short distance away at the point of interconnection of the 115-kv transmission facilities of the Generating Company and those of Georgia Company at the Georgia-South Carolina State Line. From the aforementioned filing and other information submitted to the Commission by the three companies it appears that all of the energy delivered to Georgia Company is thereafter resold and consumed at points outside of the State of South Carolina; and

[1] Accepted for filing effective October 1, 1953, and designated as Generating Company's Rate Schedule FPC No. 1.

[2] Identified as Fxhibit A to Generating Company's Rate Schedule FPC No. 1.

it further appears that all of that delivered to South Carolina Company is thereafter resold and consumed at points within the State of South Carolina.

Under the foregoing agreements which are to terminate in 1979 each purchaser is entitled to a maximum of one-half of the output of each of two 75,000-kw generating units presently installed at the Urquhart station;[3] subject, however, after both units are in service, to the right of Generating Company on twelve months' notice to reduce Georgia Company's entitlement by 25,000-kw and South Carolina Company's by 30,000-kw. In the event of an outage of one of these units Georgia Company would be entitled to one-half of the output of the remaining unit and to no service upon the outage of both. After the plant is in service, Generating Company may cancel its obligation to Georgia Company upon thirty months' notice.

Billing under both agreements is in accordance with a two-part capacity and energy type rate. The basic capacity charge to each amounts to $15.30 per kw per year, subject to adjustment to reflect any difference in amounts of estimated investment and fixed operating costs of the Urquhart Station as set forth in the agreements from those actually experienced.[4] But in the case of the sale to the Georgia Company this basic charge is increased by the addition of a component of $7.20 per kw, or $540,000 annually. That additional amount is said to have been agreed to as representing 50% of the savings accruing to Georgia Company by reason of its purchase of energy from Generating Company in lieu of constructing an equivalent amount of capacity on its own system.

The energy charge to both customers is designed to cover certain stated operating expenses connected with the Urquhart station estimated to amount to 3.49 mills per kwh.

According to the agreements the basic capacity charge, which as currently adjusted amounts to $18 per kw per year, covers interest on and amortization of the principal of 90% of Generating Company's investment (including working

[3] The first unit was placed in service in November 1953, and the second unit in January 1954.

[4] As currently adjusted the basic capacity charge amounts to $18.00 per kw per year.

capital) in the Urquhart station over a period of 25 years;[5] return on the remaining 10% equity at 8%; and an amount for insurance, Federal, State and local taxes, administrative and general expense and operating supervision and labor costs. The energy charge, currently estimated at 3.49 mills per kwh, covers fuel and maintenance expenditures incurred in the operation of the Urquhart station together with any generation taxes imposed upon the Generating Company.

Upon being informed that the staff was undertaking an analysis of its rates, Generating Company several times requested and held informal conferences with members of the Commission's staff, in the course of which its representatives submitted two computations of the company's cost of serving Georgia Company during the 12-month period ending October 31, 1953. Inasmuch as no service was rendered to Georgia Company prior to November 1953, the studies extensively employed estimates. One of these based the determination of the cost of serving Georgia Company upon the integrated system costs of Generating Company and South Carolina Company but without any allowance for the difference between the limited service rendered from the two units of the Urquhart plant and firm power service from South Carolina Company's integrated system. The other reflects Generating Company's service costs based on a hypothetical "orthodox capitalization plan"[6] for the Generating Company instead of the actual 90% debt and 25-year amortization plan.

In the submission of both studies Generating Company's representatives alleged without supporting data that the $540,000 extra annual charge to the Georgia Company is justified, chiefly because of (1) additional obligations and risks voluntarily incurred by South Carolina Company in underwriting the entire investment of Generating Company; (2) anticipated higher financing costs South Carolina Com-

[5] Generating Company's plant investment associated with the aforementioned two generating units approximates $27,000,000 which was financed per one million dollars of capitalization as follows:

$750,000 — 25 year 3⅞% bonds
$150,000 — 10 year 4% debenture notes
$100,000 — equity at 8%

[6] The capitalization assumed by Generating Company contemplated a debt ratio of 50% at a rate of interest of 3½%.

pany will incur in the future due to a reduction of the equity ratio shown on its consolidated balance sheet as a result of Generating Company's high debt ratio; (3) services rendered by South Carolina Company in the planning, financing and construction of the Urquhart station for which no charges were made, and selection of the location of the plant mainly for reasons favoring the Georgia Company; (4) the failure of the Public Service Commissions of Georgia and South Carolina and the Georgia Company to voice any objections to the agreements at the time of their execution; and (5) the possibility that the cost of any additional capacity installed in the Urquhart station in the future to serve South Carolina Company may exceed that of presently installed capacity and result in higher charges to ultimate consumers in South Carolina.

On June 18, 1954, the Public Service Commission of Georgia filed a letter with this Commission stating in part as follows:

> It is the view of this Commission that there appears to be undue discrimination in the Generating Company's rates in favor of its parent and it is also our view that it would be in the public interest to make further inquiry in the matter of discrimination to determine whether or not some revision in the rates should be made. We would like to state further that in the event there should result any downward modification in the demand rate charged Georgia Power Company, it will be our purpose to see that such reduction in power cost is passed on to the consumers of Georgia Power Company.

In view of the foregoing the Commission finds it necessary and appropriate in carrying out the provisions of the Federal Power Act to order as hereinafter provided.

The commission *orders*:

(A) Generating Company shall make a showing of the facts necessary to enable the Commission to find and determine whether:

(1) Generating Company, by virtue of its ownership and operation of the facilities to effectuate the above-described sale of electric energy to Geor-

gia Company owns and operates facilities subject to the jurisdiction of the Commission.

(2) The sale to Georgia Company is a sale at wholesale in interstate commerce, subject to the provisions of Sections 205 and 206 of the Federal Power Act and the rules and regulations thereunder.

(3) The rates and charges for the service to Georgia Company as set forth in Generating Company's Rate Schedule FPC No. 1 are unduly discriminatory within the meaning of Section 205 of the Federal Power Act and unlawful; and whether the Commission should order that Generating Company file a new rate for that service eliminating all substantial differences between the charges and related provisions of the schedule of rates to Georgia Company and those of the rate schedule in effect for the service to Generating Company's parent-customer South Carolina Company.

(4) The charges to Georgia Company provided for by such rate schedule are unjust and unreasonable; and if so what rate the Commission should order Generating Company to file.

(B) Without in any way precluding or limiting Generating Company from making any showing it wishes to make of facts relevant and material to the questions posed by this order, and without prejudice to any position Generating Company may wish to take as to the significance or lack of significance of the facts hereinafter specified, and also without this Commission at this time deciding that question but reserving full freedom to decide all the questions on the full record in the light of all arguments that may be adduced before it, Generating Company shall show its cost of rendering the service to Georgia Company, calculated in accordance with applicable Commission precedents and using, among other things, (i) a prudent investment rate base with the deduction for accrued depreciation computed on the basis of

straight line depreciation; (ii) a fair rate of return; (iii) taxes actually to be paid over the life of the contract. This showing shall be made for the first two units in commercial operation; (1) for the calendar year 1954 using actual experience insofar as data are available for the period the two units shall have been in commercial operation and estimates based upon actual experience for the remainder of that year; (2) for every fifth year thereafter for 25 years, by use of the same figures with adjustments to reflect changes in net investment, return, and federal and state income taxes, and other changes which are known and measurable with reasonable accuracy.

(C) Subject to the same conditions and reservations as set forth in (B) above, Generating Company shall show its revenues from Georgia Power for the same years based upon the same operations under its Rate Schedule FPC 1.

(D) The foregoing showing shall be submitted in writing under oath within 60 days of the issuance of this order, with sufficient copies to provide 5 for the Commission, 2 for each of the State Commissions of Georgia and South Carolina, and 1 each for any others who may have been admitted as interveners.

(E) A public hearing on the foregoing issues be held at a time and place to be fixed hereafter.

(F) Interested State commissions may participate in this proceeding as provided in Sections 1.8 and 1.37 (f) [18 CFR 1.8 and 1.37 (f)] of the Commission's General Rules and Regulations.

By the Commission. Commissioner Digby dissenting.

/s/ Leon M. Fuquay
Leon M. Fuquay,
Secretary.

Adopted: October 27, 1954
Issued: October 29, 1954

In the Matter of
South Carolina Generating Company } Docket No. E-6585

ANSWER OF THE SOUTH CAROLINA GENERATING COMPANY

The South Carolina Generating Company ("Generating Company") by way of answer to the Order of the Commission of October 27, 1954, respectfully shows to the Commission:

1. The South Carolina Generating Company is a South Carolina corporation, organized in 1951, under and pursuant to the laws of the State of South Carolina in such cases made and provided; all of its property is located in the State of South Carolina, and it is a wholly owned subsidiary of the South Carolina Electric & Gas Company, which company is also a South Carolina corporation organized and existing under and pursuant to the laws of that State.

2. The South Carolina Electric & Gas Company ("Electric & Gas") is a South Carolina corporation engaged, *inter alia,* in the business of generating transmitting, distributing and selling electrical energy within the State of South Carolina. Prior to 1946, Electric & Gas was a subsidiary of General Public Utility Company, a registered Holding Company. In 1946 Electric & Gas became an independent, operating electric utility, wholly free from holding company supervision or control, through a stock divestment plan. Its stock is widely held by approximately 30,000 stockholders. Thereafter, in 1948, it acquired the properties of the South Carolina Power Company which operated in a contiguous service area, whose divestment by its holding company, Commonwealth and Southern, had been ordered by the Securities and Exchange Commission. This latter company was merged into Electric & Gas in 1950. Electric & Gas now operates in twenty-six (26) counties in central and southeastern South Carolina, and is an electrical utility under the laws of South Carolina, subject to the jurdisdiction of the Public Service Commission of South Carolina as to its rates, services, issuance of securities, and other matters.

3. In common with other electrical utilities, Electric & Gas in the post-war period experienced a phenomenal growth, requiring the addition of substantial generating capacity. By the summer of 1950 it had substantial steam electric gen-

erating facilities in the northern and southern portions of its system and began planning its next steam generating facilities in the west-central area, contemplating the building of a plant on the Edisto River near Branchville, South Carolina. When there was public announcement in November, 1950, of the Atomic Energy Commission to locate its large hydrogen plant in territory served by Electric & Gas, negotiations were begun by Electric & Gas with E. I. duPont de Nemours and Company ("duPont") as agent for the AEC, to meet the power requirements of AEC at its Savannah River plant, which at that time were estimated as divers figures running as high as 250,000 kw. In the early stages of these negotiations it became evident that duPont would require rates lower than Electric & Gas could furnish if it financed its generating plant on the usual debt ratio and that in order to serve AEC it would be necessary to finance with a higher debt ratio in line with the capital structure of Electric Energy, Inc., which served AEC's needs at Paducah, Kentucky.

The Georgia Power Company ("Georgia") was at that time in need of additional generating capacity in the Augusta, Georgia, area, just across Savannah River from the AEC site, and was planning to install near Augusta a steam unit with a capacity of approximately 66,000 kw. Georgia learned of Electric & Gas's plans and approached it as to the possibility of additional units being built at its contemplated station, to be located on the Savannah River rather than on the Edisto River, and a sale of a portion of the capacity thereof, together with the energy therefrom, to Georgia in lieu of each company's building separate plants.

4. These negotiations between Electric & Gas and du Pont, and between Electric & Gas and Georgia [1] resulted in

[1] The salient factors to be included in the Georgia agreement were covered in a letter dated June 26, 1951, to Georgia which was tentatively accepted by them on June 29, 1951, subject generally to assurance as to firm commitments for construction and feasibility of financing. The formal contract executed November 9, 1951, is on file with the Commission as Exhibit "A" to South Carolina Generating Company's Rate Schedule, FPC No. 2.

By June 15, 1951, negotiations with du Pont had proceeded sufficiently for Electric & Gas to write them a letter on that date outlining the principal factors in a proposed agreement, although at that time the proposal contemplated 63,000 kw contract demand by du Pont. This letter, with modifications including the reduction of contract demand to 30,000 kw, formed the basis for the du Pont-AEC "Letter of Intent" dated January 11, 1952. The du Pont contract was finally executed on March 1, 1954. The first draft of the contract with Georgia was dated July 18, 1951, and the contract was executed November 9, 1951.

the incorporation of the South Carolina Generating Company, the construction by it of Plant Urquhart with two 75,000 kw units, the financing of the construction costs by the issuance of debt securities for 90% of the costs, and the furnishing by Electric & Gas of the equity capital of 10%.

5. South Carolina Generating Company is engaged solely in the business of generating electrical energy in the State of South Carolina; all of its property is located within that State. It is an electrical utility subject to the jurisdiction of the Public Service Commission of South Carolina as to its rates, services, issuance of securities, and other matters. Its entire output of energy is sold under three contracts, one with Georgia, the second with du Pont, both as aforementioned, and the third with Electric & Gas, previously filed with the Commission as an exhibit.

6. In response to paragraph (a)-(1) of the Commission's order, this Respondent is the owner of a short transmission line between the Urquhart generating plant on the Savannah River and the Georgia-South Carolina state line, over which electrical energy required by Georgia contract is delivered to Georgia as is more fully hereinafter set forth.

7. In response to paragraph (A)-(2) of the order, this Respondent shows that its sale of electric energy to Georgia is a sale at wholesale, delivery being taken at the Georgia State line, presumably for use in that State, said electric energy having been generated in South Carolina, and that this is the only sale at wholesale made by Generating Company of energy not consumed within the territorial limits of the State of South Carolina.

8. In response to paragraph (A)-(3) of the order, this Respondent denies that the rates and charges for its services to Georgia are unduly discriminatory within the meaning of Section 205 of the Federal Power Act, denies that these rates and charges are unlawful, and avers that any differential between the rates and charges to Georgia and those to Electric & Gas are based upon legitimate differences in service, increased cost of financing Electric & Gas due to the high debt ratio of Generating Company, and because of the financial assistance rendered to Generating Company by Electric & Gas in setting up its capital structure.

9. In support of its above allegations that subject contract presents a rate that is neither unreasonable nor unduly discriminatory, Respondent respectfully directs the attention of the Commission to a fundamental consideration inherent in any review by a regulatory body of contracts of the nature involved in the case at bar:

Serving the public interest in the broad sense is the prime objective. The application of a theoretical cost formula, to the extent of disregarding other factors, is not the only test of public interest, and the review of estimated costs reflected on statements filed herewith should be made with due regard to the inconclusiveness of such statements viewed without adequate allowance for surrounding facts and circumstances. Projections indicate that billing under the present terms of the contract will each year be less than "costs" on a 6% return basis until 1962, and that subsequent annual billing excesses over "cost" will not absorb the accumulated deficit under 6% until 1970. A study of the attached statements would reveal that for 1954 the rate of return per year under the contract will be 4.64%; for 1955 it will be 4.97%; 1956 will be 5.11%; 1957, 5.25%; 1958, 5.39%; not until 1959 does it reach even 5½%: in that year it is 5.54%.

Any "Cost to Serve" statement involves some judgment factors but Statement 1, filed herewith, rests almost entirely upon estimates projected twenty-five (25) years into the future, most of which can and probably will change, and some of which involving a consideration of such factors as obsolescence, tax rates, money rates and even, perchance, disaster, can radically change overnight without having any or a proportionate effect upon the billing under the power contract. This further disqualifies the cost to serve formula as an exclusive measure of the reasonableness of rates. It not only ignores the value of the service which may be jeopardized by rate changes to conform to a "cost" measure, but it is also an imperfect measure of "cost" and the farther the projection, the less perfect is the focus.

Attention is directed to the use of a 6% return on this statement. The use of high debt ratio by Respondent inevitably required a high equity ratio on the parent company

for consolidated leverage. This displaced equity capital on the parent with its higher annual return and tax requirements are present in the system which fathered the Generating Company but are not to be found on the books of Respondent. Also, the normal risks of the utility business are exceeded in the investment here involved which should be reflected in the return of Respondent and its parent as guarantor. The 6% rate may well be an inadequate measure of these system factors. The fact that such rates might, at some future date, yield a greater than a fair return is certainly an inadequate motive for disturbing those rates now during a period when they yield no greater than a fair return, and present the cheapest means by which the purchaser, Georgia, can secure the capacity and energy.

Surely, the *value* of the service to Georgia is a pertinent factor which cannot properly be ignored in contemplating any Commission step which might conceivably deprive Georgia of the benefits it now receives from the use of capacity and energy of the Urquhart Station. The decision by Generating Company to permit the contract to run for its full term or to terminate it at an earlier date will necessarily rest on the economics of the contract. From present indications, continued inflationary increases in cost will in all probability necessitate Electric & Gas exercising their contractual right of recapture of the full capacity now under contract with Georgia at an early date, which in all probability would be before we would have recovered from Georgia the full costs during such period on a fair value basis. Any development which reduces the economic value of the contract will tend to speed the day of recapture. This will necessarily require Georgia to replace this capacity and energy—and such replacement will necessarily cost substantially more than the capacity and energy it will thus lose. Surely unreasoning adherence to a theoretical formula should not be allowed to blind justice to realities that will benefit no one: neither the seller nor the purchaser, nor their respective ultimate consumers.

Even at the time of the negotiations in 1951—and it should be borne in mind that construction costs have risen since that

time—had Georgia built the 66,000 KW unit it planned, the resulting KWH cost of generation at a 90% load factor was estimated to amount to .965c per KWH. The joint study also disclosed that by participating with Electric & Gas for a plant with two units under one roof and financing on a high debt ratio basis, that the cost of such a project by Electric & Gas, on the same load factor, would result in a cost of .672c per KWH.

The resulting contract with Georgia was predicated on dividing the benefits so derived approximately one-half to each company.

Starting in 1955, the first full normal year of operation, the KWH cost of power will amount to 0.709c per KWH, and the cost per KWH substantially declines in the remaining years of the contract, which substantially supports our contention that Georgia's cost is less under this plan than if they had constructed a different type of plant; it also substantilly supports our estimates.

Distributing the benefits resulting from such a joint venture between Georgia and Electric & Gas in providing additional generating facilities required by both companies, has substantially cut the cost of producing power, and the advantages and benefits resulting from this joint venture have benefited not only the customers of Electric & Gas but also those of Georgia.

10. The above mentioned advantages accruing to Georgia cannot be found merely in the dollars appearing on a statement delineating the cost of service. Rate payers in the State of Georgia, served by Georgia, enjoy advantages far above those which would be, or would have been, experienced by them had Georgia constructed a generating station in the Augusta area. These may be briefly summarized in three categories, *id est*: (a) financial, (b) operating, and (c) technical.

(a) The financial advantages are implicit in the special type of financing employed by Respondent as compared with the normal type of financing which would be necessary for a Georgia Company plant. The statement of cost to serve discloses that in early years and for quite some time payments

required for the finance component and related taxes are substantially below a 6% return on the net investment. Furthermore, Georgia, at a time when it was faced with demands for substantial physical additions throughout its system, was relieved of the necessity of raising funds to provide for the construction of an Augusta station. A comparison of the sales and use tax statutes of the States of South Carolina and Georgia discloses exemptions in the South Carolina statute for the cost of machinery to be used in the production of electric energy with no such exemption in the Georgia statute, resulting in higher plant costs in Georgia for the construction of like facilities, and so a greater amount of financing would have been required.

(b) (1) Operating cost advantages also are apparent from a comparison of these statutes, the South Carolina sales tax statute providing for the exemption of the cost of fuel used in electric generation with no comparable exemption in Georgia. Other operating costs advantages in the Urquhart Station in comparison with a single unit station to be constructed by Georgia arise from economies in operating personnel costs spread over 150,000 KW capacity which would be relatively higher in a plant of lesser capacity.

(2) If Georgia had constructed a one unit station at Augusta, Georgia as they had proposed prior to contracting with the Generating Company, they would have suffered a 100% loss in capacity, with its attending voltage troubles, in event of outage of this unit, whereas, under this contract with Generating Company, they would have only a 50% loss in event of outage of one unit since, under their contract, they are entitled to 50% of all available capacity from the two units. Investment costs per KW also average less than in a station of greater capacity.

(3) Under their station ownership plan, it would have been necessary for Georgia to maintain minimum load requirements during certain off-peak hours when it would not have been economical for them to do so, whereas, under Generating Company contract, they are allowed to reduce their take below minimum load requirements on steam unit provided other loads on steam unit are sufficient to make up

this deficit. This factor has proven a considerable advantage to Georgia.

(4) Under the Georgia ownership plan, the unit maintenance cost would probably have been higher than the maintenance cost which Georgia bears under its purchase contract with Generating Company inasmuch as the station load factor of Generating Company is higher than the load factor of the Georgia load and since the maintenance is allocated on the basis of usage, Georgia benefits by this operation.

(c) Technical advantages which also produce dollar savings to Georgia include the advanced design of the Urquhart Station with an estimated 10% improvement in fuel economy over the design contemplated by Georgia for its station.

11. It should also be borne in mind in the public interest that the retail rates of Georgia generally compare favorably with those of Electric & Gas due to accidents of geography such as proximity to fuel sources and metropolitan concentrations. A reduction of rates under the contract here being considered would tend to increase this differential, especially in view of the fact that a given amount of decrease in cost to Georgia serving in excess of 500,000 electric customers would have less favorable impact per customer than the adverse impact per customer for the 160,000 customers served by Electric & Gas.

There is no basis in the relative sizes of companies involved for any inference of bargaining advantages to Electric & Gas, or that either was indifferent to the best interest of its customers in promulgating the subject contract; therefore regulation would be ill-advised to jeopardize the demonstrable values presently enjoyed by Georgia in order to achieve an exact conformity to a rate making formula, which at best is only a rough guide to desirable results, Georgia is, insofar as Respondent can ascertain, still satisfied with the agreement.

12. Since there is only one sale by Respondent over which the Commission could conceivably have jurisdiction, all other sales being subject, without argument, only to the regulation

of the South Carolina Public Service Commission, the Commission cannot consider the question of undue discrimination against Georgia by Respondent's sales to Electric & Gas, which question has been raised at least by inference.

Even if the Commission could consider the question, there is clearly no discrimination in such premises, as Electric & Gas has assumed certain burdens in its relation with Generating Company, in order to effectuate and enjoy the benefits from the construction of Generating Company's steam electric generating station at such an enormous savings—benefits shared in by Georgia and its customers—the cost of which burdens reduces the monetary differential existing between the price paid by it and the price paid by Georgia.

Briefly, some of these are:

(a) The impact on the capital structure of Electric & Gas of the financing involved;

(b) The guarantees by Electric & Gas of completion of construction of the plant and of earnings therefrom;

(c) The guarantee of Electric & Gas to take over the obligations of the plant in case of disaster, in which cases Georgia is relieved of further obligation under the agreement here under discussion. The proximity of this plant to the AEC project does not make this disaster hazard unrealistic.

(d) The guarantee of Electric & Gas of back-up in certain instances of Generating Company sales.

(e) Under Generating Company's contract with Georgia, it is Generating Company's obligation to control and regulate the flow of power over Georgia's interconnection. In order to accomplish this, it must either isolate a unit on Georgia, or Electric & Gas must isolate a portion of its system from its other interconnections. Therefore, when one of Generating Company's units is out of service, Electric & Gas must either lose its share of the capacity from Generating Company or split its system at other points. Under such split conditions, it would not be able to avail itself of all of its capacity on its other stations. To overcome this condition, it will be necessary for Electric & Gas to install phase shifting equipment at an estimated cost of $600,000. This phase shifting equipment would consume approximately 375 KW of power. There-

fore, the total annual investment, maintenance, and operating cost would exceed $100,000.

(f) Service to Electric & Gas is actually inferior to that rendered Georgia under its contract, due to the subordination to the AEC of the parent company rights to capacity in the event of an outage of one unit. The commitment to provide capacity for AEC was recognized before the Georgia contract was negotiated.

13. Subject to the reservation above set forth denying the Commission's right to consider the question of discrimination, it is further respectfully urged that since the rate charged to Georgia does not exceed the true cost of rendering that service, and since that rate is just and reasonable and since ultimate consumers of Georgia are not placed at a competitive disadvantage with consumers of Electric & Gas, any differential in rates and charges does not make the rate to Georgia discriminatory within the meaning of the Federal Power Act.

14. Answering paragraphs (B) and (C) this Respondent submits the attached statements 1 and 2 with supporting details. Respondent further respectfully states that these statements, together with this answer, are interdependent, and must be read and considered together as a whole.

15. Respondent, South Carolina Generating Company, avers that the arrangements under which it came into being, its financing, its construction of the Urquhart plant, and its marketing of the power therefrom, have resulted in substantial benefits to Georgia and to the Atomic Energy Commission, its only two independent customers, in that by reason of these arrangements it has been able to furnish substantial amounts of power to each of these customers at rates and charges less than this power could be obtained from any other source; that the rates and charges here involved are just, reasonable and non-discriminatory within the meaning of the Federal Power Act; and that these arrangements, as evidenced by this answer and the contracts referred to herein, if not disturbed by this Commission, will result in substantial benefits to all ultimate consumers concerned over the period of the contracts.

WHEREFORE, having fully answered, this Respondent asks that the Commission declare that the rates and charges under its contract with the Georgia Power Company are just and reasonable and not unduly discriminatory.

Respectfully submitted,
South Carolina Generating Company
(Sgd.) J. M. Costello
By .....
J. M. Costello, Vice President

Columbia, S. C.
January 15, 1955

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DECISION

EMORY J. WOODALL, *Presiding Examiner*

In the Matter of
South Carolina Generating Company
Docket No. E-6585

UPON AN INVESTIGATION OF RATES AND CHARGES

APPEARANCES

For South Carolina Generating Company

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For South Carolina Public Service Commission

CLYDE F. BOLAND, *Chairman,* South Carolina Public Service Commission

ROLAND BOYLE, *Esquire,* Columbia, South Carolina

For Georgia Public Service Commission

WALTER R. MCDONALD, *Commissioner* and N. KNOWLES DAVIS, *Chief Engineer,* Georgia Public Service Commission

For Federal Power Commission

HOWARD E. WAHRENBROCK, *Assistant General Counsel,* and THEODORE FRENCH, *Esquire,* Washington, D. C.

WOODALL, Presiding Examiner: The order initiating this proceeding issued October 29, 1954, relates to the arrangement whereby South Carolina Electric and Gas Company (S. C. Company) created a wholly-owned subsidiary company, South Carolina Generating Company (Generating Company) as the instrumentality to build, finance and operate the Urquhart steam electric generating plant, which besides making other deliveries provides a supply of electric energy up to 75,000 kw as part of the energy requirements of the Georgia Power Company (Georgia Company). The agreement for such sale by the Generating Company dated November 9, 1951, was filed with this Commission, was accepted for filing effective October 1, 1953, and was designated as South Carolina Generating Company's Rate Schedule FPC No. 1. It was incorporated in evidence by reference as Item A in this record.

RATE INVESTIGATION ORDER

The Order Initiating Proceeding is attached hereto as Appendix A for convenience.[1] Generating Company was ordered to "make a showing of the facts necessary to enable the Commission to find and determine whether" among other things "the rates and charges for the service to Georgia Company * * * are unduly discriminatory," and whether the same rates and "charges to Georgia Company * * * are un-

[1] The facts related in the order are not in evidence. Neither is Respondent's answer in evidence. The facts will be found from the evidence of record.

just and unreasonable; *and if so* what rate the Commission should order Generating Company to file." (Italics added). It was further ordered that

> "Generating Company shall show its costs of rendering the service to Georgia Company, * * * using, among other things, (i) a prudent investment rate base with the deduction for accrued depreciation computed on the basis of straight line depreciation; (ii) a fair rate of return; (iii) taxes actually to be paid over the life of the contract."

The contract was for a 25-year period. It further provided:

> "* * * This showing shall be made for the first two units in commercial operation: (1) for the calendar year 1954 using actual experience insofar as data are available for the period the two units shall have been in commercial operation and estimates based upon actual experience for the remainder of that year; (2) for every fifth year thereafter *for 25 years,* by use of the same figures with adjustments to reflect changes in net investment, return, and federal and state income taxes, and other changes which are known and measurable with reasonable accuracy. * * *Generating Company shall show its revenues from Georgia Power for the same years based upon the same operations under its Rate Schedule FPC 1." (Italics added).

In the order setting the hearing herein issued March 17, 1955, Generating Company was ordered to open and close in the presentation of testimony. Counsel for Respondent in opening stated: ".....in following that procedure, we do not concede, of course, that there is any burden of proof on South Carolina Generating Company in regard to the issues here." Continuances were granted until May 18, 1955, when evidence was first taken.

JURISDICTION

The following finding and conclusion is adopted from Respondent's Brief:

> "The South Carolina Generating Company's transmission line from its Urquhart plant to the Georgia line is a facility used for the transmission and sale of electrical

energy at wholesale in interstate commerce. Therefore the Commission has jurisdiction of this facility and of the contract under which the Respondent sells electric energy at wholesale to the Georgia Power Company. All of the property of the Respondent is located in South Carolina. It and its parent company, the South Carolina Electric & Gas Company, are subject to regulation by the South Carolina Public Service Commission, and the Federal Power Commission's jurisdiction is limited to the regulation of the wholesale contract between the Respondent and the Georgia Power Company." (p. 2)

The jurisdiction of the Commission over the sale by Respondent to Georgia Company is established by all the evidence of the transaction, and is conceded by all parties. That the sale is at wholesale for resale in interstate commerce and that the transmission of electric energy to Georgia Company is in interstate commerce is established and conceded.

THE POSITION OF THE PARTIES

The following is quoted from Respondent's Brief:

"The South Carolina Generating Company pleads in its Answer to the Commission's Order that its rates and charges to the Georgia Power Company under the contract in issue here (Item A) are not unjust, unreasonable or unduly discriminatory within the meaning of the applicable statute.

"It contends that the contract was freely made between two independent power companies acting at arms length and is mutually advantageous to the Georgia Power Company and to the Respondent and its parent, South Carolina Electric & Gas Company. By reason of this contract the Georgia Power Company is able to obtain a large block of power without any capital investment and at a saving of some half million dollars a year to its customers. The Respondent contends that since the contract results in this saving to Georgia, the requirement of the statute that rates be neither unjust nor unreasonable has been met. But even if the return on the contract is measured by a cost of service formula the rates are not unreasonable or unjust.

"Since the Commission has jurisdiction of only one rate, since the Respondent is the wholly owned subsidiary of South Carolina Electric & Gas and since Electric & Gas and Georgia Power serve entirely different areas, the case presents no question of undue discrimination. But if it does, the obligations assumed by Electric & Gas justify any difference in the rates which may be found between the Respondent's contract with Georgia and the one with its parent.

"The Georgia Power Company defends the contract as fair and beneficial to it (Branch, Ex. 1, pp. 3-4, R. 97-107. 114-115, 144-5) at the time it was made and now. This position the Georgia Power Company clearly stated to the Georgia Commission in its letter of May 5, 1954 (Davis, Ex. 10)." (pp. 3-4)

The following is quoted from Brief of Staff Counsel:

"At the hearing, Clyde F. Boland, Chairman, and other representatives of the South Carolina Commission entered their appearance and Mr. Boland submitted a statement expressing approval of the contracts of Generating Company, contending that no comparison should be made between the Georgia Power contract and the State regulated E&G contract, that in any case the contracts are not discriminatory in view of the burdens on E&G, and that the rate to Georgia Power was reasonable (Tr. 404-407). He also submitted a copy of the South Carolina Commission's order of January 2, 1952, purporting to approve the two contracts (Tr. 408). The South Carolina Commission presented no evidence and took no part in the examination of witnesses.

"The Georgia Commission was represented by Walter R. McDonald, Commissioner, and Mr. N. Knowles Davis, Chief Engineer. Mr. McDonald made a statement to the effect that the Georgia Power contract was discriminatory and unfair. Mr. Davis took part in the cross examination of Respondent's witnesses and presented testimony designed to show that the fixed charge element of $7.20 per kw per year in the capacity charge to Georgia Power was in excess of the cost of service and should be eliminated". (Ex. 43). (p. 7)

The following is quoted from Answering Brief of Georgia Public Service Commission:

"It is the position of the Georgia Public Service Commission that the rate charged by South Carolina Generating Company for delivery of power to Georgia Power Company is unjust, unreasonable and unduly discriminatory within the meaning of those terms in the Federal Power Act.

"The Georgia Commission contends this to be true by reason of the substantially higher rate charged Georgia Power Company than South Carolina Generating Company charges either of its other two customers (South Carolina Electric and Gas Company and E. E. dupont De Nemours & Company, Inc.), that reasonableness of the rate charged Georgia Power Company can be measured neither by what an alternate source of power would cost Georgia Power Company (including other alleged advantages to that Company), nor by what an alternate capitalization of South Carolina Generating Company and corresponding fictitious results of operation would prove. The Georgia Commission contends that undue discrimination exists in rates and charges as between the customers of the Generating Company which subjects the customers of Georgia Power Company to an undue disadvantage. The Georgia Commission further contends that the rate differentials not only reflect undue discrimination, but in addition establish as a fact the unreasonableness of the rate charged Georgia Power Company.

"Respondents take the position that the difference in the rates, being subject to separate regulatory jurisdiction, does not, in and of itself, create a discrimination. The Georgia Commission contends, however, that each of the three rate levels were initiated and filed by Respondent without rate hearings or investigation by any regulatory body to determine reasonableness, and furthermore all three rates relate to the same service provided from the same facilities. The fact that the South Carolina Public Service Commission has jurisdiction over one or more of the rates of South Carolina Generat-

ing Company does not deprive the Federal Power Commission of jurisdiction to find that undue discrimination exists.

"The Georgia Commission further contends that the rate applicable to the Georgia Power Company contract should be measured in the manner adopted by the parties to the contract."

The position of the Commission's Staff is set forth in a 65-page brief. The Index shows the following main points:

I. The rate for the service to Georgia Power Company is unreasonably high.

II. The rate is unduly discriminatory against Georgia Power Company, and this confirms its unlawfulness.

THE ISSUES

The rate investigation order (in clause A paragraph (2)) specifies that the sale of electric energy to the Georgia Company "is a sale at wholesale in interstate commerce, subject to the provisions of Sections 205 and 206 of the Federal Power Act." Paragraph (3) questions whether "the rates and charges for the service to Georgia Company as set forth in Generating Company's Rate Schedule FPC No. 1 are unduly discriminatory within the meaning of Section 250 of the Federal Power Act and unlawful." Paragraph (4) questions whether "the charges to Georgia Company provided for by such rate schedule are unjust nd unresonable." Section 205 (a) of the Federal Power Act declares any "rate or charge that is not just and reasonable" to be unlawful. Subsection (b) of Section 205 forbids any public utility in "any transmission or sale subject to the jurisdiction of the Commission" to "(1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service." Section 206 (a) requires the Commission to "determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force" whenever the Commission "after a hearing had upon its own motion or upon complaint, shall find that

any rate, charge, or classification * * * is unjust, unreasonable, unduly discriminatory or preferential."

Two issues are thus raised:

(1) Are the charges to Georgia Power unjust and unreasonable?

(2) Do the charges make or grant undue preference or advantage, or cause undue prejudice or disadvantage?

The problem is as narrow as the contract to furnish electric energy to Georgia Company because that transmission and sale is the scope of interstate commerce by Respondent. The problem differs from a rate case which tests a tariff of rates and charges to numerous interstate customers. This problem is whether *one sale* to *one customer* under a particular contract is unjust and unreasonable, including testing whether the differences from other transactions which are intrastate are unreasonable differences, i.e., unduly discriminatory. To fix the interstate rates herein would be to fix the specific price of electric energy from Generating Company to Georgia Company. It would not be determining a schedule of rates of general application to numerous customers as in the more usual rate case, because Respondent has but one interstate customer. This sale was made under a specially negotiated arrangement to deliver electric energy to another electric utility located in another state; not as the result of fulfilling a public utility duty to serve any and all consumers or customers within its service territory. The basic inquiry here is not what generally applicable rates to the public are just and reasonable, because this Respondent makes but three sales;[2] but whether this particular sale to the Georgia Company is just and reasonable? This basic distinction has a bearing upon the nature of pertinent proof.

The order initiating this proceeding, as quoted above required proof relative to the 25-year contract period, namely, cost of service data for 1954 and for every fifth year there after for 25 years. The Respondent actually furnished more than was required.[3] The test issue—just and reasonable—was to apply to the whole 25-year contract and period, not

[2] 75,000 kw to Georgia Company, 45,000 kw to its parent (S. C. Company), and 30,000 kw to the AEC Hydrogen Bomb Project.

[3] The first five years—1954, 1955, 1956, 1957, 1958—were also furnished, and much of the detail for 1961 was also shown.

just to some one test year. The test went to "its revenues from Georgia Power for the same years";[4] to its "prudent investment rate base with the deduction for accrued depreciation computed on the basis of straight-line depreciation" for the 25-years, not just for one year; and to "taxes actually to be paid over the life of the contract," not just computed for one year. The evidence must be evaluated with respect to meeting these particular requirements of the Commission's order.

The Organization of Generating Company

This story is best told in the words of Respondent's witnesses:

"A. In common with other electric utilities experiencing phenomenal growth in the post-war period, South Carolina Electric & Gas Company had been faced with the necessity of adding frequently to its generating capacity; in view of this condition, it had on order a turbo-generator unit, boiler and other plant equipment, the size unfixed, delivery of the unit being scheduled for August, 1952. Several sites for this proposed plant had been under consideration. With substantial steam electric facilities in the north and southeast extremities of its system, it had become apparent that the next such facilities should be located in the west-central area and extensive location studies had been made by the midsummer of 1950. Special consideration was given to a site near Branchville, South Carolina, since this location was particularly well suited for the South Carolina Electric & Gas Company's system and would result in minimum transmission loss. However, before definite site determination had been made, an announcement was made by A.E.C. that it expected to locate an enormous Hydrogen Bomb Project in the territory served by the Company, about fifty miles west of the Branchville site. Early in December, 1950, representatives of duPont Company, prime contractors for the Savannah River Project of A.E.C., contacted Electric and Gas officials in regard to construction and operating power supply for the Savannah River

[4] Clause (c) of this Order Initiating Proceeding.

Project. They were advised that Electric & Gas then had on order a turbo-generator unit, and that it would build a plant of sufficient size to supply all of the A.E.C. power requirements.

"Q. Mr. McMeekin, will you state whether or not you were actively engaged in a discussion with the duPont rep-representatives concerning the possibility of evolving a contract for the power supply for the A.E.C. Savannah River Project.

"A. I was, and from the outset of such discussions I was assigned the task of developing a satisfactory rate for such power supply. On January 13, 1951, duPont was given an initial proposal for its operating power requirements.

"Q. What was the reaction of the duPont representatives to the initial proposal insofar as rates quoted?

"A. The duPont people indicated that the quoted rates were too high and that they were looking into other possible supplies, including the possibility of supplying all such requirements from their own plants. It was also sensed by the Company's representatives that the negotiations with duPont were being somewhat colored by arrangements which A.E.C. was making with Electric Energy, Inc., for its power supply at Paducah, Kentucky, and that a very important factor in the Paducah rate had been brought about by special financing for that project in which the ratio of debt to total capitalization was approximately 95%." (Witness McMeekin in Exhibit 5, p.4)

"It became obvious that normal financing would not produce a plant which could sell power at a price which would sell to AEC. It was but a normal and logical step to resolve this problem in approximately the same manner it had already been worked out for AEC by Electric Energy, Inc. * * * Quite obviously Electric & Gas because of its Indenture restrictions could not finance such a plant on the basis contemplated. Hence the formation of a separate corporation was necessary." (Witness Costello, Executive Vice President, in Exhibit 6, pp. 2, 3)

By financing Generating Company on the basis of 75% mortgage bonds, 15% ten-year notes, and 10% common equity held by the parent S. C. Company, a rate to AEC, based on such high-debt ratio financing, which would satisfy AEC was made possible, and a contract to supply 30,000 kw of electric energy was ultimately executed.[5] To secure the business from AEC the S. C. Company (the parent) was required to make certain burdensome commitments. These were listed in Exhibit 5 by Witness McMeekin as follows:

"1. It was necessary for the Electric & Gas to make certain improvements in its transmission system so that service to A.E.C. would be of unusually high quality.

"2. It was necessary for Electric & Gas to guarantee deliveries to A.E.C. under certain conditions. In case of an outage of one unit, such guarantee would result in an 83% loss of its contracted for capacity, of 45,000 kw, whereas such a one-unit outage would result in only 50% loss for the Georgia Power Company.[6]

"3. It is also the obligation of the Electric & Gas to continue to supply the Generating Company's commitments to A.E.C. in event of outage of both units other than that of a force majeure type of outage. Under this commitment, Electric & Gas not only suffers 100% loss in its contracted for capacity with the Generating Company but also is committed to furnish 30,000 kilowatts of capacity to A.E.C."

Other factors considered in reducing the rate to duPont were:

(1) It was a government plant.

(2) It was bringing in a large number of people into the service area of the S. C. Company.

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[5] The contract with E. I. duPont de Nemours and Company (on behalf of and for the risk and benefit of the U. S. Atomic Energy Commission—AEC) is Exhibit 12. As duPont was merely the agent for AEC reference to AEC will usually be made and references to duPont will refer to AEC. The parent actually had to put up about 15% equity. (T. 527) The duPont contract was not signed until after the plant was put into operation in 1954, namely, on March 9, 1954, effective on January 11, 1954, with the first power being delivered on February 10, 1954. (T. 544, 567, 568)

[6] Only 75,000 kw capacity is left. AEC gets 30,000 kw, Georgia Company gets 37,500 kw (50%), and S. C. Company gets the balance of 7,500 kw. (T. 470)

(3) We wanted to meet competition from public power agencies, such as Santee-Cooper and Clarks Hill, which AEC had contacted regarding supplying power to the Hydrogen Bomb Project.[7]

The same factors were otherwise stated:

"The fact that they were building up our residential load."

"We wanted to establish character by getting it (this business) in our own territory." "They had brought in a tremendous amount of new business." "We were in competition with public agencies in trying to get the Atomic Energy business." (T. 558, 576)

Those things were considered and "we came up with $19 as being something we felt we could justify taking into consideration and sell duPont." That figure had the components of $15.30 (the same as in Georgia Company contract) and $3.70.[8] The initial rate quoted to duPont was higher than the rate finally negotiated.[9] Witness McMeekin testified to the effect that his company would not have agreed to sell to Georgia Company at the rate given to the AEC. The benefits to South Carolina Company to be derived from selling to Georgia Company are not deemed to be equal to those received from selling to AEC.[10] When the Generating Com-

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[7] T. 526

[8] T. 558; Witness Gordon also evaluated the AEC contract as having an influence upon system credit. "If the Company had not been able to build the Urquhart Plant, even though the 35% equity capital ratio might have been more quickly achieved, it would have been regarded as unfavorable by the investor, if the Company was not able to take care of the requirements in its own territory." T. 213

"Overall, it seems to me to have been to the advantage of the company, looking ahead for its cost of money, to have built the Urquhart Plant. It was necessary to have this kind of capitalization in order to be able to get the AEC contract. Therefore, it was in my opinion in the interests of the company to adopt this unconventional method for the advantage that it gave, and, therefore, it obviously should be the goal of the company to gradually achieve a conventional average equity base * * * It reduced the cost of money for the Generating Company. It increased the cost of money for the parent, but it would be my estimate that the advantage, the savings to the Generating Company more than offset the added expense to the parent company, including the intangible factor taken seriously into consideration by the investor that South Carolina Gas and Electric Company was able to meet the requirements in its own service area.

Q. "You say more than offset. How much more than offset?

A. "That I don't believe anybody in the United States with all the IBM machines, could answer for you exactly." T. 215

[9] T. 563

[10] T. 575, 576

pany's plant capacity is not required by the Georgia Company or by their own system, AEC has been allowed by special agreement to take, and have taken, in excess of the 30,000 kw contract maximum because taking at a load factor of more than 100% by AEC, tends to reduce costs.[11] This benefits Georgia Company and S. C. Company. The decision to build the two unit plant (called Urquhart) was made before Georgia Power Company came into the negotiations, and before the exact kw requirements of AEC were fixed. In fact, the second unit had been ordered in the spring of 1951, and this plant was not dependent on selling to Georgia Company.[12] The capacity could have been used in their own system without the Georgia sale.[13] The special financing (90% debt ratio) was used to permit quoting to AEC an acceptably low rate for electric power. It was recognized then that the parent (S. C. Company) must undertake special burdens to sell AEC because of the special financing of the new subsidiary to make the low rates feasible. But as of the hearing date Witness McMeekin testified that "the overall project was desirable by the company," i.e., creating and financing Generating Company as against the extra burdens.[14]

In this setting of facts, the Georgia Company contract was negotiated.

Negotiation of the Contract with Georgia Power Company

Respondents' witnesses present the facts as follows:

> "The Georgia Company had become aware of our plans to construct a plant adjacent to the Savannah River Project Area and of the type of anticipated financing. Georgia Company officials advised representatives of Electric & Gas that they were contemplating the construction of a one unit steam station near Augusta, and that they then had on order a 60/66 MW unit for use at that station. Consequently, it was suggested that a cost study be made, considering the feasibility of some arrangement whereby Georgia could secure its required capacity for the Augusta area from the Generating Com-

[11] T. 577
[12] T. 490, 539-541
[13] T. 492
[14] T. 574

pany station, rather than construct its own plant, inasmuch as it appeared that with the special financing available to the Generating Company, a considerable saving would be available to Georgia Company.****** In order to determine the overall economics of the two conditions and the possible saving to Georgia Company, under the two conditions, it was necessary to compare the plant cost and other cost factors under the two different propositions, that is, the plant as Georgia Company would have to finance it, and the plant as Generating Company planned to finance it. Estimated plant costs on these two bases were prepared by Gilbert Associates, Inc., engineering consultants for Generating Company, and by Southern Services, Inc., engineering consultants for Georgia Company. In general, these estimates were in fairly close agreement. Several meetings between the Georgia Company and its engineering representatives and the Generating Company and its engineering representatives were held during the spring of 1951 to resolve the differences in the estimates." (Witness McMeekin in Exhibit 5, pp. 5, 6.)

"It was generally agreed that an equitable split in savings between the two costs would be the proper approach. It was the opinion of the representatives of both parties that a more equitable contract could be written if the contract were based on a two-part rate, namely, demand and energy. The demand charge was to be based on estimated plant cost and other fixed charges, including operating labor, with proper escalation provisions, and the energy charge was to be based on actual fuel and maintenance cost. After much negotiation and taking into consideration other factors, it was finally agreed that a capacity charge of $22.50 per KW per annum, based on the then estimated plant and other operating costs, would be an equitable one; this resulted in an estimated savings to Georgia in capacity cost of $5.38 per KW per annum, or a total annual saving of $403,500. **** Based on present day fuel cost and present load factors of the Georgia load, it is estimated that the savings accruing to Georgia would be in the order of $175,-

000 to $200,000 annually—in addition to—$403,000 per annum in capacity cost." (Witness McMeekin in Exhibit 5, pp. 6, 7, 9)[15]

"It was agreed that Georgia would obtain 75,000 KW on the high side of the station step-up transformer bank and since the guaranteed rating of the turbo-generator was 75,000 KW at its 13.2 KV terminal, the agreement to deliver 75,000 KW net to Georgia on the 115 KV side of the station step-up transformers represented a considerable concession."

The contract charges were negotiated upon agreed bases, including contract capacity charge of $15.30, of which one element was computed to amortize 90% of the debt and return 8% on the assumed 10% of equity, and the other element was the operations component of $4.80. Both of these were subject to escalation for variation of estimated and actual investment, and of variations of expenses, including operating, general and administrative, and taxes, from actual expenses.

The other component of contract charges was the energy charge including cost of fuel, maintenance, and related taxes. This was estimated at $.00315 per kwh.

Witness Ready describes the third element of the negotiated $22.50 per l.c. contract charge as follows:

"The contract provides for an additional capacity charge of $7.20 per kw which is not related to any costs to be found on the books of South Carolina Generating Company. This amount was negotiated as a sharing between Generating Company and the Georgia Company of substantial economies estimated as accruing to the Georgia Company under the contract as compared with the construction and operation of a generating station of its own. These substantial savings are primarily attributable to the assumed 90% debt financing from which Georgia derived the benefit, and it should be borne in mind that the parent company, if we brush aside the

[15] The $22.50 was negotiated before the split into $15.30 and $7.20 was computed and agreed on. T. 519. The $22.50 studies used in negotiating did not take into account the costs to the parent, S. C. Company, resulting from special financing and the AEC's sale. "The term 'cost' as contemplated by the parties to the contract has reference to the outlays necessary to do the job rather than the term as it may be used in an accounting sense." Ready, Exhibit 2, p. 2.

artificialities of corporate entity, is actually the vendor which financed this project and in so doing the parent had to provide equity leverage for this debt. In other words, there are costs on the books of the parent company which should be taken into account in addition to the costs to be found on the books of Generating Company, and these costs may be roughly measured by the spread between the cost of servicing equity capital and the average cost of servicing total capital to the extent that capital funds of the parent company had to be provided exclusively from equity to provide such leverage." (Exhibit 2, p. 4)

"The computation of taxes on income included in the projection of the cost to serve the Georgia Company, which is Statement No. 1 filed with the Commission on January 15, 1955, is related to the assumed 6% return of the net investment. For this purpose it was assumed that the deduction for interest would not be the amount of interest to be paid by Generating Company, but would be the interest payable by Generating Company if its debt were 50% of its capitalization, consistent with capitalization ratios implicit in the 6% return. As alluded to previously in the discussion of the additional capacity charge, the dislocation in the capital structure of the parent company will have resulted in a disproportionately high equity ratio with a correspondingly low debt ratio and the loss of interest deductions in computing its income tax, to the extent of the difference between actual interest of Generating Company and the interest used in computing the tax element in its cost to serve. The result is essentially the *system* tax." Exhibit 2, pp. 5, 6)[16]

[16] Witness Gordon supported the necessity to maintain normal system capitalization ratios under cross-examination. T. 217-238. "It has cost it increased costs of money because the debt ratio is so high. The bonds, for example, are rated Baa. If the debt ratio were lower, the bonds would be rated higher, in my opinion, and the bond money would cost the company less. * * * the bonds would be rated A * * * if the ratio were, let's say, 31 per cent * * * equity * * * and that the debt ratio was down to approximately 52 or 53 per cent." T. 238. It increased the cost of bond money to the consolidated system, and of preferred and common stock. This system has gained a plus factor by having met the requirements of the U. S. Government in its territory. It "has more competition considerably than the average privately owned utility company * * * through the Santee-Cooper operation and the Clark Hill project." T. 239

The same witness summarizes the several commitments, which the parent, S. C. Company, was required to undertake to obtain the financing of its wholly owned subsidiary as the instrumentality to generate and transmit the electric energy to AEC, to Georgia Company and to the South Carolina distribution system, as follows:

> "As sponsor of the Generating Company and as one of its three power customers, Electric & Gas had made a number of very significant commitments to purchasers of project securities, vendors, and to Generating Company, which are of very great value to the latter company and of potentially great cost to Electric & Gas. Although it is difficult to assign a monetary value to these intangible contributions by the parent company, they should be given due weight, together with the more measurable costs arising from the previously mentioned displacement in capitalization ratios; in any comparison between the rate to Georgia Power Company which includes the $7.20 per kw additional capacity component and the rate to South Carolina Electric & Gas Company which does not. ***** The parent company initiated a number of major equipment orders and remained as a contracting party after Generating Company was organized.
>
> "In bond and note purchase agreements the parent company guaranteed the payment of commitment fees, if the securities were not sold.
>
> "In bond and note purchase agreements the parent company was obligated to provide any excess funds required to complete the station or upon failure to do so to provide sufficient funds to redeem outstanding debt.
>
> "Under the Indenture and note purchase agreements the parent company is guarantor for the payment of principal and interest on the bonds and notes until after certain earnings conditions are met for twelve consecutive months of operations.
>
> "Under bond purchase agreements the parent company agrees to make up any deficiency in insurance in the event that the station is destroyed or partially destroyed.

"In the parent company's power purchase contract with Generating Company, the parent is obligated to supplement its payments for contract capacity to the extent necessary to provide an eight per cent return on Generating Company equity after expenses, taxes, interest and debt amortization.

"In this power contract the parent agrees to be responsible for any contract capacity reduced or cancelled by any of the other contracting parties, and in the event of such cancellation at the request of the parent company, to pay for such capacity at the same rate as the party relinquishing same.

"Under this power purchase contract the parent company is also obligated to successors or assigns of Generating Company.

"Under the power contract between Generating Company and duPont, to which the parant company is a party, the parent company is obligated to supply any deficiency in electric service to duPont unless such deficiency results from force majeure." (Exhibit 2, pp. 7-9)

Witness McMeekin summarized the savings to Georgia Power Company as follows:

"1. The overall efficiency of this plant is approximately 10% higher than that proposed by Georgia. Consequently, fuel consumed per KWH is approximately 10% less.

2. No fuel tax applicable as contrasted to a three percent tax on fuel burned in Georgia.

3. If Georgia Company had constructed a one unit station at Augusta, as they proposed, they would have suffered a 100% loss in capacity, with its attendant voltage troubles in the event of an outage of this unit, whereas under the contract with Generating Company, they have only 50% loss in event of outage of one unit and it would be very improbable that they would ever suffer 100% loss of capacity.

4. Reduction in maintenance cost due to maintenance allocation being on a kilowatt-hour basis produced is another saving. Since the plant production is con-

siderably higher than that proposed on the Georgia plant, the unit maintenance cost will be correspondingly lower.

5. Under the Georgia ownership plan, it would have been necessary for Georgia to maintain minimum load requirements during certain off peak hours when it would not have been economical for them to do so, whereas under the Generating Company contract they are allowed to reduce their take below minimum load requirements on steam units provided other loads on steam units are sufficient to make up this deficit. This factor has proven of considerable advantage to Georgia." (Exhibit 5, pp. 8, 9)

Georgia Company profits by the transformer losses (approximately 458 kw under full load conditions) under outage conditions. That some of these benefits also inured to others did not destroy or reduce them.

The contract further provided for reducing the plant cost by the savings calculated to result when additional capacity to the plant was added. Originally computed at $200,000 it was in fact credited to Georgia Company at $581,000. This credit was made effective as of the date of the first contract deliveries which was about two years before the third unit went on the line.[17]

The Georgia contract has a recapture clause. Witness Costello describes it as follows:

"Section 4.03 of the agreement provides for the recapture, at will, by Generating Company of not over 25,000 KW upon twelve months notice. Section 4.04 provides that all of the contract demand not already taken under Section 4.03 may be recaptured upon thirty months notice. In a system which is expanding as rapidly as ours the cost of new plants is an ever present and saliently impelling factor. When Plant Urquhart ws originally constructed, only two units were ordered—each of 75,000 KW capacity. Before these were completed, a 100,000 KW unit was ordered. The first two units were completed last year (1954), and work is already well in progress on the installation of this third unit. Already

[17] Exhibit 5, p. 10; T. 544.

plans are being formulated for the construction of still another plant to support the ever-increasing load of the system. Quite naturally this requires us to assess at short intervals the cost of constructing these new plants against the return we derive from the capacity at Urquhart used by Georgia Power. When this latter amount reaches a point below the former, in the absence of some other impelling motive of which I am not currently aware, recapture will follow as a rational and normal result. And I will also say that increased costs evidenced in just the few years since this contract was executed have brought these two factors already dangerously close together." (Exhibit 6, pp. 4, 5)

Witness McMeekin explains the advantage of the recapture clause in cross-examination:

"* * * if the plant cost and other factors contributing to cost go up sufficiently to where it would be a saving to our rate payers to recapture this contract, of course, it will be to our advantage to do it. We certainly always attempt to do the most economical job we can."

The converse was said to be true. However, cancellation is subject to bondholder approval, *and approval by this Commission.* Testimony indicated that if the revenues from the contract became smaller the point of time when recapture would be cheaper than additional construction of generating capacity to enable the S. C. Company to continue to render adequate service within its service territory might be reached sooner. Counsel for Respondent states in rebuttal that to point out such a logic of the situation was not to make a threat of cancellation.[18]

Regarding financing Generating Company testimony pointed out that in connection with financing 75% long term bonds and 15% ten-year notes it was necessary for S. C. Company to assume additional intangible obligations and guarantees beyond supplying the equity capital, so that the true cost to the parent company of the financing of the Generating Company, which is applicable to measuring the cost to serve Georgia Company, is higher than the bare cost of money

[18] Testimony also pointed out that there is no cancellation or recapture clause in the contract with the AEC.

incurred by the system, which is measured by the costs incurred during the three year period 1951-1954.

Total capitalization at the end of 1951 of $84,516,000 (before there was any subsidiary) was divided into:

63.25%	debt
10.87%	preferred
25.88%	common equity
100.00%	

After financing Generating Company with 90% debt, and increasing the equity ratio of the parent company to compensate for the impact on the system credit of the high debt ratio financing of Generating Company, the system ratios at the end of 1954 were:

62.83%	debt
9.40%	preferred
27.77%	common equity
100.00%	

These 1954 system ratios are comparable to the 1951 ratios of the parent company before there was any subsidiary company. To accomplish these 1954 capitalization ratios, despite the dilution of equity caused by the 90% debt financing, the parent company was required to issue a disproportionately greater proportion of equity securities, namely, 72% of the increase in parent capital was common equity, only 18% was preferred and only 10% was debt. These ratios are almost the reverse of the high debt ratios of the financing of the Generating Company.[19] The result in terms of parent capitalization were:

52.64%	debt (reduced from 63.25%)
12.35%	preferred (increased from 10.87%)
35.01%	common equity (increased from 25.88%)
100.00%	

These parent company capitalization ratios were thus again approximately at the electric utility industry normal levels of 50% debt, 15% preferred, and 35% common equity. The additional system cost of money up to the end of 1954 is

[19] Statements 4 and 4(a) of Exhibit 3.

measured by the disproportionately larger ratio of equity capital issued by the parent company. But such extra cost of money must continue until the parent, S. C. Company, had by the further issuance of disproportionately greater ratios of equity capital fully corrected the system dilution of capitalization, i.e., until the system capitalization reached the industry norm of 50% debt, 15% preferred, and 35% common. The evidence presents the estimates of these additional costs to serve[20] based upon the progressive and gradual injection of new capital at a rate of approximately 10%, which represents the 10-year electric industry average growth factor. It also represents this system's experience in plant growth[21] and in electricity sales.[22] Respondent shows that by 1960 the system capitalization ratios will have been brought into line with industry-wide normal averages, as mentioned above, marking the end of the additionl costs of money involved in the cost to serve under study here. This is reflected on Table I, in the last column entitled "Actual Cost, %," where it is shown that 1961 marks the high point of money cost to the system—6.3536%, which cost declines each year thereafter, once the system capitalization has been stabilized. The projection of capital growth in Statement 7 of Exhibit 3 is perhaps the basic exhibit in this case. From that projection, grounded and controlled as outlined above, come all the computations of capital elements entering into cost to serve during the 25 year contract period, including capital ratios affecting forward computations of Federal Income Tax expense as an element of operating expense.[23]

Statement 7(c) of Exhibit 3 performs a very important function in the estimates of cost to serve. It demonstrates the relationship between system finance costs and the finance costs of Generating Company, chargeable against th first two units at the Urquhart Station, i.e., one-half of which is applicable to service to Georgia Company. This part of the Respondent's estimates of cost to serve is the most im-

[20] The 1955 figures were based upon current calculations of load increase.

[21] Statement 7(a) of Exhibit 3

[22] Statement 7(b) of Exhibit 3

[23] Mr. Davis for the Georgia Public Service Commission moved to strike all of this evidence and testimony. But, of course, it was exactly the type of relevant evidence, which the Commission's order directed to be presented.

portant part of the evidence of the true costs incurred in providing electric energy from the Urquhart Station. The testimony of the sponsoring witness, Ready, is quoted, as follows:

> "*Statement 7(c)* (Exhibit 3) entitled 'Segregation of System Capital and Related Annual Costs Between the First Two Units at Urquhart Station and the Remainder of the System' is designed to demonstrate why the weighted average system cost of money, rather than the cost to be found on the books of the Generating Company, is the proper measure of the costs to the system in connection with the two unit project at the Urquhart Station. For this purpose we have taken the year 1961 as representative. The statement is divided into four sections, the first section showing the system growth capital in use during 1961, the cost of which including related taxes is 11.9743%[24] The second section shows the capitalization of Generating Company in that year applicable to the first two units at the Urquhart Station. Due to the preponderance of debt, the average cost on the basis of capital ratios to be found on the books of the Generating Company is 9.1868%. The third section is headed 'Displacement' and refers to parent company capital which is displaced, or out of its normal capitalization ratio position, if we consider the system capitalization ratios as normal for that year, due to the necessity of providing leverage for the capital of the Generating Company in connection with the first two units. The fourth section entitled 'Non-project' represents system capital which is unaffected by the project financing. Thus the statement shows system growth capital of approximately $178,000,000, project capital of about $23,000,000, non-project capital of about $140,000,000 and approximately $14,000,000 of capital in limbo, that is, occupying temporarily and in-between status wherein the money is actually used for non-project purposes, but its cost is abnormal due to the influence of project financing. Therefore, we have allocated a part of the annual cost to the project and a part to non-project use.

[24] Composed of "weighted finance rate in 1961—6.3536% plus the tax factor of 5.6207%. Exhibit 3, p. 6.

The amount allocated to non-project use is the normal or average system cost of such capital measured by applying the average system rate to the total dollars. The remainder, which amounts to $650,000, is the excess of cost for such capital arising from project financing. This is the detriment to be found in the costs of parent company capital and we have applied this amount as an additional cost for units 1 and 2. The result of adding $650,000 to the $2,142,000 of cost previously determined results in a total of $2,792,000 of system costs for Generating Company capitalization for units 1 and 2 for the year 1961, resulting in a composite rate of 11.9744% which is substantially the system rate, the minor difference being obviously due to dropping fractions. If we apply this rate to the rate base applicable to Georgia, we have a return and related tax of $1,324,452." (Exhibit 3, pp. 7, 8)

The Position of the Georgia Power Company

The Georgia Company was not a party to the proceeding but Mr. Harllee Branch, Jr., President of Georgia Power Company was a witness for Respondent and stated the position of his company.[25]

Early in 1951 the Georgia Company ordered a turbo-generator unit of 60/66 mw and bought a site for a generating plant near Augusta, Georgia. At about the same time representatives of Georgia Company were negotiating with S. C. Company for 75,000 kw of electric energy for distribution in the Augusta area. This decision was based upon the following considerations:

"(a) The cost of power from a two-unit plant is cheaper than the cost of power from two single-unit plants built at approximately the same time and in the same locality;

(b) Plans for the South Carolina plant, only about two miles from our proposed site, were further advanced, and it was felt that the needed power supply for the Augusta area could be obtained more quickly and more cheaply from that source;

[25] Exhibit 1. Staff Counsel objected to this testimony.

(c) Special financing, not available to our Company was possible for the South Carolina plant. The South Carolina Company offered to share these benefits, together with other savings in construction and operating costs, with our Company.

(d) Our Company was, and had been for a number of years, involved in a large expansion program so that it was considered desirable to limit our capital outlays wherever possible without prejudicing our service or rates. This could be done by purchasing our power requirements for the Augusta area; and

(e) It was possible for our Company to obtain additional service protection by contracting for power from a two-unit plant with the right to utilize one-half of whatever capacity was available at the plant in the event of a unit failure."

On cross-examination, Mr. Branch emphasized the advantages to Georgia Company of the contract with Generating Company. He stated that he was fully aware of the capture provision, that it was not unusual, and that it represented a fair and acceptable arrangement. The avoidance of obtaining and investing capital in a new plant by Georgia Company was a real advantage, as the company has been expanding plant investment at the rate of $35 million to $40 million per year for 10 years.

"If someone else would build the plant for me and do it on terms that would compare favorably with my cost, I was delighted to have them carry a part of my burden for me.[26]

"My motivation * * * was to put off as long as we could the investment and expenditure of money in that area in the light of our other capital burdens."[27]

"That is, where I said we had been facing a big capital expansion program. And I might say I think it is a direct advantage to my ratepayers to void as much of that capital expansion as I can because of the fact that we thereby less dilute our capital structure and have to acquire or obtain less new financing and the results

[26] T. 98
[27] T. 105

of that ultimately, I believe, is a saving and a benefit to them as well as to the company * * * We were able in this particular case to have a plant built at a money cost * * * and our 75,000 kilowatts * * * at a money cost appreciably more favorable than would have been possible under our capitalization ratios to build the same capacity. To that extent it was not just a benefit to the company, but it was a benefit to the ratepayer in that any expense which enabled us to hold our rates and our expenses at the existing level, was more favorable than one that might have compelled a rate increase. * * * There is no question in my mind that we are getting a lower expense in the operation of the plant attributable to the cost of money."[28]

Estimates then made showed cost of financing the Urquhart capacity to be $22.50 per kw against $27.80 per kw for the same capacity in a plant built by Georgia Company. Later computations after costs went up showed about $25 per kw against $31 per kw for Georgia's plant. The witness still thought he had made a good contract and would do it today! This was emphasized several times.

"A. My understanding, as I tried to indicate by my prior testimony, was that they had that special financing in contemplation and it was one of the things that motivated us in seeing if we could get under what somebody here referred to as that special financial umbrella.

"Q. My point is: Was your participation necessary to raise the umbrella, as you understood it at the time?

"A. I certainly say this, and that is the reason I am a little embarrassed about these proceedings in addition to feeling that we made a good contract. I know, because my people sat in on some of those discussions, that investors who financed this plant took Georgia Power's contract into consideration in their willingness to finance this plant. So I was informed by my people, and I am therefore embarrassed and concerned if the contract should be altered or set at naught, for the impact * * * maybe I ought not to say this, but

[28] T. 98, 99

I am seriously concerned * * * that that might have on any future efforts to do what I understand this Commission would like to see these independent companies do, and that is integrate their systems and build capacity one for the other wherever it is cheapest.

"Q. Then it is fair to say, is it, that you feel your participation made possible the financing and the method that was adopted and the construction of a two-unit plant?

"A. The second unit. I think they could easily have financed on the H-bomb contract and their own service the one unit. They may have financed a two-unit plant, but certainly ours did enter into the willingness of the investors to finance the second unit. I think that is a fair statement."[29]

The Nature of Respondent's Showing Regarding Cost to Serve

Without raising any question of law, such as to the legal duty of Respondent to prepare and file specified evidence, or to open and close, and without argument, either during the hearing or in its briefs, as to what party must sustain the burden of proof in a rate investigation proceeding pursuant to Section 206(a) of the Federal Power Act, the Respondent made the showings it was ordered to make for the 25-year contract period. Respondent's exhibits furnish estimates (beyond the actual data for the partial year 1954) for 1955, 1955, 1956, 1957, 1958 (the first 5 years) and for 1963, 1968, 1973 and 1978 (the four remaining 5-year intervals). In accordance with Commission Opinion No. 264, provisions for future taxes arising from accelerated amortization are treated as elements of cost in the period in which taxes would otherwise have been incurred. Net cost to serve the Georgia Company varied from a high of $3,568,000 in 1955 (for 459,900,000 kwh) to $2,767,300 in 1978 (for 525,600,000 kwh) or a cost per kwh from .00776 in 1955 to .00527 in 1978.[30]

Revenues from the Georgia Company contract varied from $3,262,300 in 1955 to $3,485,900 in 1978 or a per kwh rate of

[29] T. 125, 126.

[30] Only 255,400 kwh were generated in 1954. Statement 1, Exhibit 7, Statement 3 of Exhibit 2 presents the comparison on a 6% return basis.

.00709 in 1955 to .00663 in 1978. In 1963 the contract revenues will exceed the cost to serve ($3,355,200 minus $3,295,600 equals $59,600 in excess of a 6% return for that year); but cumulatively the 6% return will not be exceeded until 1970. On that showing the contract in the last nine years of the contract period would produce a revenue in excess of a 6% return, depending upon the stability of price and estimated costs and upon how accurate the estimated 3% straight-line depreciation rate turns out to be and upon the modifications of tax impact upon earnings during the 25-year period. Stated differently, the same showing means that in the year 1962 the contract revenues for the first time will produce a 6% rate of return (6.06%), and cumulatively calculated the contract revenues will have produced a 6% rate of return (6.04%) for the period the contract has run by the end of the year 1970.[31] for 1955 the lowest rate of return earned will be 4.97% (cumulatively 4.81% by the end of 1955); and for 1978 the highest rate of return earned will be 13.95% (cumulatively 6.95% by the end of 1978). By the end of the 25-year contract period the investment in plant (rate base) allocated to the service of the Georgia Company will have been depreciated by the application of a 3% straight-line rate of depreciation from $14,021,000 in 1954 to $4,146,000 in 1978.[32] On the showing for the 25-year period of a straight-line 6% return basis, as an average cost of money, which cost varies from year to year, a 50 percent system equity-debt ratio was used as a system average ratio of equity to debt for part of the 25-year contract period, which average ratio is consistent with the 6% straight-line return used for the 25-year contract period, which period the Commission's order required the Respondent to use in showing whether its contract with the Georgia Company will produce during the 25-year period just and reasonable rates and charges to the Georgia Company. The 6% straight-line rate of return and the 50% system equity-debt ratio is also consistent with the 3⅝% rate of interest, which approximates

[31] Exhibit 7—Statements 1 & 2; Exhibit 2—Ex. VI, Statement 3. As actual operational data cover only part of 1954, the evidence necessarily represents estimates of plant investment, working capital, materials and supplies, expenses, taxes and revenues from the contract with the Georgia Company for the 25-year period.

[32] Exhibit 2—Statement 3.

the cost of debt money under the circumstances of system financing here involved.[33]

The comparison of contract revenues (five-year intervals, 1955 through 1978) with the cost to serve the Georgia Company on the actual system cost of money basis is as follows:

Year	Actual System Cost of Money Basis (000)	Contract Revenues (000)	Actual Cost Rate (5)
1955	3,456	3,262	5.9306
1958	3,495	3,291	6.2076
1963	3,371	3,355	6.2716
1968	3,158	3,406	6.1442
1973	2,968	3,454	6.0829
1978	2,773	3,486	6.0479

The high point of cost would be in 1961[34] when the rate of 6.3536% would be produced. In that year the deficiency of contract revenues to produce $1,020,030 net income after taxes at a 6% rate of return is $29,698, and the deficiency to produce $1,140,534 net income after taxes on the actual system cost of money basis (6.3536% in 1961) is $133,744.[35] Prudent investment rate-base was supported by detailed cost estimates and experienced cost figures agreed upon by the engineering representatives of S. C. Company and the Georgia Company. Having agreed upon capital costs, which were borne out in experience to date, engineering and other representatives of the S. C. Company and the Georgia Company agreed upon a method of computation of charges, which is shown to be closely correlative to the cost to serve over the 25-year contract period. This is illustrated by comparing the computed revenues to be received by the Generating Company from the Georgia Company under the contract (rate schedule). The net cost to serve the Georgia Company and the revenues from the Georgia Company contract are shown for the 25-year contract period on two bases of comparison. One compares revenues to costs estimated on an average 6% rate of

[33] Exhibit 3—Statement 7—25-year Projection, from 1951, of Growth of System Capital, etc.

[34] Exhibit 3—Statement 9. This basis is alternatively used in the showings made. The actual system cost of money is one standard of measurement of cost to serve against contract revenues. See Table I Below.

[35] Statement 10.

return basis (6% cost basis). The other compares revenues to the computed actual system cost to serve the Georgia Company, using (not the average 6% rate of return but) the actual system cost of money. The results are shown on Table I as follows:

TABLE I

Year	(1) Deficiency 6% Cost Basis (000)[a]	(2) Cost to Serve 6% Cost Basis (000)[b]	(3) Contract Revenues (000)[c]	(4) Cost to Serve Actual System Cost of Money Basis (000)[d]	(5) Deficiency Actual System Cost of Money Basis (000)[e]	(6) Actual Cost Rate %[d]
1954	414	3010	2596	2777	181	5.679
1955	306	3568	3262	3456	194	5.93
1956	252	3500	3248	3448	200	6.04
1957	208	2476	3268	3474	207	6.125
1958	164	3455	3291	3495	204	6.207
1959	119		3319	3512	193	6.283
1960	75		3328	3503	175	6.348
1961	30	3366[e]	3337	3471	134	6.3536
1962	(14)		3346	3421	75	6.311
1963	(59)	3296	3355	3371	16	6.272
1964	(103)	[f]	3365	3325	(40)	6.238
1965	(148)		3376	3280	(94)	6.209
1966	(192)		3386	3239	(147)	6.185
1967	(236)		3396	3198	(198)	6.163
1968	(279)	3127	3406	3158	(248)	6.144
1969	(324)		3416	3119	(297)	6.129
1970	(368)		3426	3081	(345)	6.115
1971	(412)		3435	3042	(393)	6.103
1972	(456)		3445	3005	(440)	6.092
1973	(501)	2954	3455	2968	(486)	6.083
1974	(545)		3461	2929	(532)	6.074
1975	(589)		3467	2889	(578)	6.067
1976	(632)		3473	2850	(623)	6.06
1977	(676)		3480	2812	(668)	6.054
1978	(719)	2767	3486	2773	(713)	6,048

[a] Exhibit 2—Statement 3
[b] Exhibit 7—Statement 1. See Statement 3 (Exhibit 2) which gives also prudent investment rate-base and percent of return produced by contract revenues.
[c] Exhibit 3—Statement 9
[d] Exhibit 3—Statements 8 and 9. Statement 8 also shows Federal and State Income Tax deductions and rates.
[e] Exhibit 3—Statements 10 and 11
[f] The blank years were not interpolated.
[g] Column (1) is the remainder after subtracting the lesser of Columns (2) and (3) from the greater.
Column (5) is the remainder after subtracting the lesser of Columns (3) and (4) from the greater.
Variations occur by reason of rounding out figures to nearest thousand.

The actual system cost of money basis is established by Statement 7 (Exhibit 3) and is reflected in column 5 of Table I above (and in Exhibit 3, Statement 9). This is an alternate showing (see the detailed comparison in Statements 10 and 11) to the straight-line 6% rate of return development of system cost to serve. Statement 7 (Exhibit 3) shows the 25-year projection (from 1951) of system capital growth and related annual cost and taxes on income. The system debt/equity ratios are projected beginning with 63.25% debt, 10.87% preferred and 25.88% common in 1951, and reaching about 50% debt ratio, about 15% preferred, and about 35% common equity ratio in about 1960, from which point forward to the end of the contract period these system ratios remain about the same.[36]

To reach and maintain such system ratios, common stock is increased in the projection from $21,875,000 in 1951 (25.88% ratio) to $487,100,000 in 1978 (34.98% ratio). Segregation of system capital to project (Georgia Company service) and non-project is shown on Statement 7(c)—Exhibit 3 of which page 1 shows year 1961, page 2 shows year 1954. Analysis of system cost of dislocation of capital by the issuance of 90% debt by the subsidiary (Generating Company) is shown on page 1 of Statement 7(c) for 1961 as $650,120 involving $13,994,100 of dislocation.

The industry (Class A and Class B electric utilities) average capitalization ratios are shown on Statement 5 for 1951, 1952 and 1953 as:

Year	Long Term Debt	Preferred	Common
1951	49.22	13.45	37.33
1952	48.68	13.04	38.28
1953	49.83	12.77	37.40

Statement 6, Exhibit 3, shows the revenues, average net plant and rate of return for the industry for the year 1954 as follows:

Electric Utility Operating Revenues	$6,541,107,000
Electric Utility Operating Income	1,353,319,000
Average net plant	21,657,940,000
Rate of Return	6.2%

[36] Exhibit 3—Statement 4 shows system changes in capitalization 1951-1954, which establishes the basis for capital growth projection. See statement 4(a) for summary.

The foregoing is an abbreviated analysis of Respondent's exhibit showing. It is also necessary to summarize the testimony of Respondent's witnesses regarding the preparation, significance, and evaluation of the exhibits which they introduced.

Capital Growth

Before the subsidiary, Generating Company, was organized and financed on the basis of 90% debt and 10% equity, the S. C. Company (the parent) had at the end of 1951 capitalization ratios of 63.25% debt, 10.87% preferred and 25.88% common equity. There were no subsidiaries then. By the end of 1954 consolidated ratios were 62.83% debt, 9.40% preferred, and 27.77% common equity. To accomplish the increase in consolidated equity ratio from 25.88% to 27.77% and the decrease in debt ratios from 63.25% to 62.83%, the parent, S. C. Company had increased its equity ratio from 25.88% to 35.01% and decreased its debt ratio from 63.25% to 52.64%, to provide system leverage. Thus the 90% debt ratio financing of Generating Company caused the parent, S. C. Company to increase its equity ratio disproportionately in order to maintain a satisfactory financeable credit for the system. To provide funds for investment in the common stocks of its wholly-owned subsidiaries the parent company was required to sell its own equity securities and to retain earnings. 72% of the increase by the parent company in capital was equity capital of the parent between 1951 and 1954.

During this period the changes in ratios were as follows:

For the System	For the Parent (S. C. Company)
62% Increase in new debt	10% Increase in debt
7% Increase in preferred	18% Increase in preferred
31% Increase in common	72% Increase in common

Beginning with approximately $84,517,000 capitalization at the end of 1951 divided into 63.25% debt, 10.87% preferred, and 25.88% common equity, the increase to $138,613,000 at the end of 1954 was divided into 62.83% debt, 9.40% preferred, and 27.77% common equity. After 1955 an annual straight-line increase in capital is used, the factor of 10.3%

straight-line growth factor representing the growth factor from 1945 through 1955, after excluding the investment in the first two units of the Urquhart Station devoted to the service of Georgia Power Company, so as to measure growth for territorial service only.[37]

The projection of capital growth gradually increases the system equity ratio to 35% and the preferred stock ratio to 15%, which reduces the consolidated debt ratio to 50% as the normalized system ratios for the balance of the contract period. Statement 5 of Exhibit 3 shows that such ratios represent the approximately average ratios of all Class A and Class B electric utilities in the United States in 1951, 1952, 1953, as reported by this Commission's publication entitled "Statistics of Electric Utilities in the United States." These ratios for the system are required for financial soundness. Such ratios are deemed necessary by witness Gordon as a financial expert to permit future financing of anticipated growth.

In computing the annual cost of money, 3.625% was used for debt money, 4.60% for preferred, and 10% per annum. Income tax rates of 4½ for the State and 52% for the Federal were used. Weighted finance rates range upward to a peak of 6.3536% in 1961 when the tax factor is 5.6207%.

Displaced Capital

By 1960 the system common equity ratio reaches approximately 35% and preferred reaches 15% in 1961. The year 1961 is used to compute the segregation of system capitalization and related annual costs between the first two units of Plant Urquhart, which is devoted to the service of the Georgia Company (sometimes referred to as the "Project") and the remainder of the system (or "non-project"). The system cost of money in that year is 11.9743%. The project cost of money is 9.1868%. Statement 7(c) shows the segregation and costs of money, and calculates the additional cost on the capital of the parent company, which resulted from project financing with its high debt ratio and the necessity for the parent company to provide leverage for the project capitalization. Cost of money is segregated between project and

[37] Exhibit 3—Statements 4, 4(a) and 7(a).

non-project use. Non-project use has the normal or average system cost applied to $140,000,000 non-project capital. As to $13,994,100 of displaced system capital, the study shows that its cost is increased by reason of the project financing at the high debt ratio by $650,120, which added to direct project costs of $2,142,505 gives $2,792,625 of the system costs for the project (units 1 and 2).[38]

Applying this composite actual system cost of money rate of 11.9743/% to $11,061,000 (rate base in 1961) devoted to the service of the Georgia Company produces a return before taxes of $1,324,500, of which $702,800 is return at actual rates, and taxes on income on actual system rates is $621,700, of which $59,600 is State Income Tax and $562,100 is Federal Income Tax. In that year on the actual system cost of money basis the deficiency of equity return after payment of taxes is $133,744, and on a straight-line 6% return basis is $29,698.[39] On the projected actual system cost of money basis shown in Statement 9 of Exhibit 3, the Georgia Power contract revenues are not sufficient to cover system costs until 1964 and the accumulated deficiency is not overcome until 1971. Statement 10 of Exhibit 3 was developed expressly to contrast the two showings (6% straight-line return basis and actual system cost of money basis). Exhibit 3 reflects the taxes, [39a] the overall return and equity return of the columns in Statement 10 and proves the soundness of the tax figures. The tax effect on the system of the high debt-ratio in financing the project resulted in an increased cost to the parent company, because the parent being required to increase its equity ratio (to correct the system ratios) would have less interest to deduct in computing Federal income taxes and would have to pay higher income taxes than it would have to pay if the system could have maintained normal ratios. The computation of system cost included the cost of normalizing the tax component of cost by using, after 1961, as system ratios the national average of Class A and Class B electric utilities. The interest deduction in 1961, for example, resulting from the normalizing of the income tax impact upon system earnings

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[38] Exhibit 3, pp. 7 and 8—W. J. Ready and Statement 7(c) page 1. Page 2 of Statement 7(c) gives the same computation for the year 1954.

[39] Exhibit 3—Statements 10 and 11.

[39a] Statement 11 of Exhibit 3

during the 25-year contract period, is $200,475 on the 6% straight-line return basis and $183,907 on the 6.3536% (actual system cost of money) basis. Actually, the abnormal impact is not removed except gradually by 1961 so that system earnings were reduced abnormally by the capital displacement in all years before 1961.[40]

It was testified by Witness Gordon, a partner of Kidder, Peabody & Co., that without the aid of the S. C. Company, its subsidiary, Generating Company, could not have been financed. The commitments assumed by the parent company were essential. The 90% debt ratio used to finance the Generating Company caused the parent company to have increased costs of financing its additional capital, and resulted in an abnormal ratio of common stock financing by the parent company. The total cost of financing the system will be greater until the system ratios are returned to about 50% debt ratio, about 15% preferred and 35% common equity ratio.[41] The cause of such higher costs is the high-debt-ratio financing of the subsidiary, Generating Company. The 50% debt-ratio, 15% preferred ratio and 35% common equity ratio are recommended as the conservative normal average for this system, especially by reason of its present and potential future competition from public power bodies in the territory, and because of the effect of higher operating costs which widely varying hydro-electric output causes. Hydro-electric generation is a substantial part of the system's capacity. To enable the system gradually to reduce debt ratio to a conservative 50% ratio (with common equity at 35% and preferred at 15% ratios), the system must have a return of at least 6%, particularly because this system's cost of raising capital "for some years" will amount to somewhat more than the industry average return which was 6.2% on average net plant for 1954 and approximately the same in 1953. As an expert in financing costs, Witness Gordon testified also that the cost of debt would be between 3½% and 3¾% for some time in the future, with preferred stock capital costing between 4½% to 4¾% or 1% to 1¼% higher than debt capital, and common stock capital needing to earn 10% or more to assure success of future common equity financing.

[40] Exhibit 3, Statement 11.
[41] Exhibit No. 4—Witness Gordon's direct testimony.

Citing correlative market prices, he testified that a 9.5% return on common equity was "minimum bare-bones cost of financing," and that an adequate margin of earnings over and above such figure was required "to provide reasonable assurance as to the successful financing" of the system. Testifying as to required rates of earnings on an over-all basis, he said:

> "Assuming capitalization ratios at objective of 50% bonds, 15% preferred stock and 35% common stock, such rates of earnings on overall bases would range from about 5.93% to 6.09%. However, in order to attain consolidated capitalization ratios of 50% debt, 15% preferred and 35% common this company must finance over the next several years with larger proportions of equity securities, and, therefor, the overall rates of earnings needed to assure successful financing would be in excess of the range of 5.93% to 6.09%.
>
> "On an overall basis I believe that earnings of at least 6% are necessary to afford reasonable assurance for successful financing of South Carolina Electric & Gas system in the near future."

The record contains no testimony contra to that of Witness Gordon. Respondent based its showing substantially on the bases recommended by this expert financial witness.[42]

The Nature of the Evidence of the Commission's Staff

Witness Goubleman's direct evidence was admitted as Exhibit 19. He sponsored the statistical Exhibit No. 18, as supplemented by Exhibit 18-A. Witness Kenneth L. Smith, Commission Supervisory Auditor, testified in Exhibit 44 and sponsored a 2-page Exhibit No. 45, entitled "South Carolina Generating Company—Cost of Service (Georgia Power Company Sales)—Year 1956." This single exhibit represents the Staff's rebuttal of the cost to serve evidence, shown by Generating Company, for the 25-year contract period of the Georgia Company contract. Witness Smith explains why he presents data for the year 1956 with modifications:

> "Data for the year 1956 were selected to indicate the cost of service which can be expected to be representa-

[42] See T. 200ff.

tive of the immediate future. Beyond the immediate future foreseeable changes in the rate base and other possible changes will undoubtedly alter the results shown in this exhibit.

"While the exhibit is based on data and information relating to the year 1956 in the showing of South Caroline Generating Company, I have made several modifications of the company's conclusions in order to obtain a proper cost of service. A field examination would possibly reveal the necessity of further adjustments. My modifications are summarized briefly as follows:

Item No.

1. The rate of interest capitalized during construction on equity funds has been reduced from 8% to 6% per annum.
2. A composite annual depreciation rate of 2.75% has been applied in accordance with the company's practice in keeping its books and issuing financial reports to investors, in preference to the 3% annual rate claimed by it for rate making purposes in this proceeding.
3. Interest deductions used for the purpose of computing the Federal income tax allowance are those for the actual financial structure of this company in preference to an assumed capitalization proposed by the company.
4. A depreciation rate of 3.25% was used in computing the Federal income tax allowance, representing the rate claimed and expected by the company to be allowed by the Internal Revenue Service, for income tax purposes. The Company used 3%.
5. The company's claimed cash working capital has been reduced by eliminating natural gas purchased from the operating expenses for which cash working capital must be provided and by making a deduction for working capital funds provided to the company through income tax accrurals collected from customers in advance of actual payment thereof to the tax collecting agency."

Witness Smith also testified as to form of rate and says:

"Notwithstanding that changes in the cost to serve Georgia Power in subsequent years are certain to occur, it is my opinion that the Commission would be justified in prescribing a fixed annual charge for the present capacity service rendered to Georgia Power by Generating Company. Regulation is a continuing process. No rate can ever be regarded as fixed or appropriate for all time. The propriety and necessity of periodic re-examination is obvious. Such procedure unquestionably is fair and reasonable for all concerned. * * * In addition, the present energy charge provision of FPC Rate Schedule No. 1 would be retained. It would be necessary however, to revise the capacity charge in the future depending upon the changes which may occur in the capacity cost elements."[43]

Describing Exhibit No. 45, Witness Smith Says:

"For use in this proceeding I have proposed Exhibit No. 45, consisting of two schedules, which sets forth the cost of service and rate base related to sales to Georgia Power Company for the year 1956 based on the showing made by the company in this proceeding. An assumed rate of return of 5½% and an assumed Federal income tax rate of 52% were used in computing such cost of service. I am not necessarily recommending, however, that these percentages be adopted for return and tax rates. While their use is provisional in this study, the methods of applying whatever rates are found proper for return and Federal income tax are appropriately illustrated in the Exhibit."

For the year 1956 Exhibit 45 shows the cost of electric energy at $21.769 per kw of contract demand. And Witness Smith recommends that such cost be substituted for the present $22.50 capacity charge in the first paragraph of Section 3.02 of the rate schedule. He also recommends eliminating "the second full paragraph of page 30 of Rate Schedule No. 1 * * * to permit either Generating Company or Georgia Power to petition the Commission for a change in the rate.[44]

Witness Goubleman testified (Exhibit 19) regarding Exhibits 18 and 18-A, showing the nature and sources of the financial data and statistics presented "to furnish the Com-

[43] Ex. 44, pp. 13, 14.
[44] Exhibit 45, p. 15.

mission with comprehensive pertinent data on which it can rely in the exercise of judgment as to the fair and reasonable rate of return for South Carolina Generating Company." Such data include average interest rates and yields, the cost of preferred stocks, earnings, pay-outs, offering prices and earnings-price ratios of common stocks, and capitalization ratios, and financial statistical data regarding S. C. Company, Generating Company and the System. Page 10e, the witness stated, sets forth the composite capital ratios at December 31, 1953 (the latest statistics thereon available) of 25 electric utilities * * * all operating for the period 1946 to date, as shown in Moody's Services, which sold common stock issues in their entirety to the public * * * as being approximately 50% debt, 12% preferred stock and 38% common stock equity. The comparison of the earnings-price ratio of the S. C. Company of 7.2% against the 25-company average 6.3%, he explains as "accounted for in great part by the relatively smaller size of (South Carolina) Electric and Gas, the relative thinness of its common stock, its lower payout of earnings" * * * between 58% and 67% of its availabble earnings.[45] The witness refers to certain language in the *Hope Natural Gas Company* case (320 U. S. 591) as laying down principles controlling his testimony. Included is the language that:

> "By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."

That quotation by the witness is, of course, not evidence, but cites the controlling law of rate regulation, which function is the work of legal counsel, not of financial witnesses. Examining the record to discover what evidence Witness Goubleman furnished to the Commission on the proper "return" about which the *Hope* case quotation speaks, it is found that the witness points out (p. 8) that:

> "Page 11 (of Exhibit 18) sets forth the capitalization and capital ratios of Electric and Gas system as of Dec-

[45] Page 9 of Exhibit 19

ember 31, 1954. At that time debt comprised 62.8%, preferred stock 9.4%, and common stock and surplus 27.8% of the total capitalization,"

and that

"Page 12 (of Exhibit 18) shows the cost of the outstanding debt of Electric & Gas System as 3.46%, and preferred stock as 4.9%."

Such data constitutes competent financial opinion evidence. But nowhere does he give the cost of common equity or compute or recommend how to arrive at the rate of return. He gives no expert opinion evidence as to the "commensurate" return of which the quotation from the *Hope* case speaks.

Witness Smith, the only other Staff Witness, very carefully stated his relationship to the issue of rate of return. As quoted above he assumed a 5½% rate of return. But Witness Smith correctly refrained from testifying or attempting to give expert testimony on the rate of return in view of his accounting qualifications and lack of expert qualifications of record regarding financial evidence. He left for some qualified witness the furnishing of evidence of the components which would establish a 5½% return.

To get from 3.46% debt cost and 4.9% preferred stock cost to a 5½% composite rate of return requires that missing elements of evidence must be supplied, namely, the cost of common equity in terms of a percentage, and the capital ratios to be used as multipliers. Such computation study is normal expert evidence for the purpose and would be subject to be probed by cross-examination. Witness Goubleman is qualified of record to testify on such financial matters. Such testimony from him would have been competent. He is qualified to give expert opinion evidence on this financial issue by furnishing the computation and the requisite component factors to produce a composite 5½% rate of return. He is qualified to support them both under direct and cross-examination. But he gave no such evidence.[46]

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[46] Had he furnished a computation such as follows below, and supported the use of each component this record would have some competent evidence from the Staff on the 5½% "assumed" rate of return, which would have put some substantial evidence underneath Exhibit 45.

Debt (system cost)	3.46%	times 62.8%	=2.17%
Preferred Stock (system cost)	4.90%	times 9.4%	= .46%
Common equity	10.3%	times 27.8%*	=2.87%
			5.50%

* System capital ratios at the end of 1954, as supported by financial evidence of Witness Goubleman.

The missing rate of return evidence is found in the Brief of Commission Staff Counsel filed October 18, 1955 and in the "corrected" brief filed October 27, 1955. The missing 10.3% "allowance" for common equity appears for the first time in any paper in the case on page 33 of said briefs and the missing components and computations of the 5½% rate of return study using system capital ratios is found on page 40 of said briefs.[47]

It is hardly necessary to remark that the missing "evidence" (component elements) by which the "assumed" 5½% return could be arrived at which are found in Commission Staff Counsel's Brief is not evidence. Even if due process did not require that such financial evidence and computation elements be presented by a witness under oath and subject to direct and cross-examination, the material would be inadmissible because it is not competent opinion evidence, because Commission Staff counsel was not presented on this record as a witness for any kind of evidence and this record shows no attempt to qualify him as a financial expert. Hence his opinion evidence as to the proper components to derive the "assumed" rate of return would not have been competent even had it been offered as evidence under oath subject to direct and cross-examination.

By way of summary then as to the Staff's evidence which is before the Commission, it is pointed out that there is no evidence of or in support of the 5½% rate of return, as computed in the Staff's cost of service. The use of 5½% return stands as Witness Smith left it merely assumed, without proof or evidence. Thus used the computations resulting therefrom have no evidentiary weight respecting any issue here involved. Exhibit 45 furnishes no substantial evidence in support of cost to serve. It is noted that counsel for Respondent made no motion regarding the disposition of evidentiary matter in Commission Staff Counsel's Brief, which is not evidence. However, no such silence by Respondent's counsel, even if it operated as a waiver or concession, can convert material which was never presented or admitted to the record through the sworn testimony of a competent wit-

[47] Respondent's Reply Brief, page 19, notes that "the components of the 5½% return" were not "known until they appeared in the Staff's brief."

ness into substantial, competent, relevant and probative evidence, which would support and give substance to the evidence. Hence, the cost to serve figure rests merely upon an assumed rate of return. No cost of service thus derived has any substance. Epecially is this true when the fair rate of return as here is the crucial issue of fact, which must be established by preponderant proof. If this were not true why try the factual issues in a required statutory hearing?[48]

The Evidence Offered by the Georgia Public Service Commission

At the opening of the hearing for the taking of evidence, Mr. Walter R. McDonald, member of the Georgia Public Service Commission, entered his appearance and that of "Mr. N. Knowles Davis, Chief Engineer of the Georgia Commission, appearing on behalf of the Georgia Commission in compliance with the Statutes of the State of Georgia."[49] In Exhibit 9 Mr. Davis described himself as an engineer with the title of "Chief Engineer." His qualifications relate exclusively to engineering activities as testified by Mr. Davis in Exhibit 9. But at the end of the exhibit he states that he has been admitted to the bar of the State of Georgia. He was permitted to act as counsel and witness.[50]

Besides Exhibit No. 9 relating to Mr. Davis' qualifications, Mr. McDonald sought to introduce a group of letters without any witness sponsoring them as exhibits. As Exhibit 10 these documents were admitted but not as evidence in this case. They were admitted as comprising part of the record as statements made by and to the officials of the Georgia Public Service Commission as part of their position as parties in this proceeding. Exhibit 43 is the direct testimony of Witness Davis.[51] He argues that the "orthodox method" of determining whether rates of public utilities are fair and

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[48] Respondent says at page 11 of the Reply Brief "While Staff Counsel's brief speaks of a 5½% rate 'which is assumed in Commission Staff Witness Smith's evidence' (p. 24), it is fundamental that findings and determinations must be made on evidence, not on assumptions."

[49] T. 10

[50] There has been some reference to the Chairman of the Georgia Public Service Commission, Mr. Matt L. McWhorter. But his appearance was never offered by anyone or entered on the record. Whether he was ever in attendance is unknown to the record. He is not known in person or by appearance to the Presiding Examiner.

[51] Admitted by the Commission on appeal.

reasonable, should not be used in this case because it produces a rate that varies as depreciation reduces the investment rate base. He argues for the use of the contract charges —capacity charges and energy charges—as cost to serve and for the cancellation of the $7.20 per kw charge, "which represents no specific cost of service."

EVALUATION OF EVIDENCE

It is appropriate to sift the evidence as to competence, probative effect, and weight. Inso doing discussion of the basis of reaching the evaluation may be involved.

The Evaluation of the Evidence of the Georgia Commission

The analysis by this Commission's Staff of the position of the Georgia Public Service Commission is adopted.

> "Mr. N. Knowles Davis, as witness for the Georgia Public Service Commission, was of the opinion that the adjustable charge of $15.30 in the Georgia Power contract represented cost and should be used as the basis of rate making while the additional fixed charge of $7.20 represented value of service and should be eliminated (Ex. 43, p. 10). It was his opinion that rates fixed in the ordinary way on the basis of current costs of service were not suitable for this type of service, for costs and rates would necessarily start high and decline over the 25-year period of the contract as the reserve for depreciation increased.
>
> "We do not believe that the record is sufficient to support a finding that the $15.30, even as adjusted, is cost of providing the capacity service. It may be that a field examination by the staff, such as has not been made, might provide such evidence, but that has been impossible under the circumstances.
>
> "Mr. Davis' recommendations go beyond what the staff feels it could recommend under the applicable precedents in another respect. As shown below the Staff's cost of service study demonstrates that current costs are in excess of the $15.30 basic charge as adjusted, or, in other words, fall less than the full $7.20 below the actual billing. To adopt Mr. Davis' view, therefore,

would mean that for a number of years Generating Company would be required to serve at less than the cost of service."[52]

Exhibit 11 summarized the analysis of Power Costs using contract charges. The Georgia Public Service Commission introduced no other evidence or testimony.

The Evaluation of the Evidence Regarding Cost to Serve

The evidence will be discussed in the order of the modifications proposed by the Staff in the methods of estimating the cost to serve.

Interest on Equity Funds during Construction

Whatever the general rule should be in general rate determinations, the Respondent may reasonably use 8% on equity funds to show the realistic cost of serving Georgia Company. Equity funds of the parent admittedly cost approximately 10%. There is no evidence to the contrary. The Staff argues from other cases not from any facts in evidence tending to show that the equity funds used during construction cost only 6%. The claim of 8% for the purpose is more conservative than the uncontradicted proof of record shows the cost of equity money to the system to be to serve the Georgia Company. All of the evidence presented by the Staff regarding the cost of system equity funds shows that 8% is reasonable in this situation to establish Respondent's cost to serve the Georgia Company.

Depreciation.

The commission ordered Respondent to use a straight-line computation. Respondent used 3% for the 25-year contract period. The Staff in its Exhibit 45 for the year 1956 used 2.75%, for expense purposes and 3.25% for tax purposes. Respondent's Controller testified regarding the 3% depreciation rate (for both tax purposes and for expense purposes) as follows:

"However, for purposes of this proceeding, with a 25-year projection in view, it is my opinion that the hazards of infant mortality, due to the proximity of the site to the hydrogen project, and of obsolescence due to re-

[52] Corrected Brief of Commission Staff Counsel, p. 56.

> cent developments in nuclear fuels, should receive more weight than are presently given from year to year on the books. It should be borne in mind that Georgia Power Company apparently regarded it as good business to contract for power at rates which amortize 90% of the cost in 25 years."[53]

On cross-examination he testified that by "infant mortality" he referred to the possible shortening of the life of the enterprise from the normal expectancy due to the especial exposure of the plant to destruction by enemy bombing in view of its proximity to the Savannah River plant of the Atomic Energy Commission. The nearness (15 miles) of the Savannah River Project of the AEC constitutes more than normal hazard both by way of danger of bombing and also from the hazards that might occur in the handling of nuclear materials.

In addition the hazard of obsolescence due to recent developments in nuclear fuels was given some weight in determining that a 3% rate for the 25-year period is reasonable. The use of a 25-year "straight-line rate" precludes annual re-examination of these elements affecting depreciation.

Witness Smith supports his use of 2.75% by 2 pages of legal argument in rebuttal to Witness Ready's testimony. He presented no evidence on depreciation. He argued that because the Respondent was using 2.75% now and because Respondent had not proved that 2.75% was incorrect, 2.75% is the right rate.

This is hardly rebuttal proof. It does not—nor does any fact the Staff presented prove or tend to prove that 2.75% is the reasonable rate to measure straight-line depreciation

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[53] Exhibit 2, p. 7. Staff counsel moved to strike this evidence on the ground that the Controller was not qualified to testify regarding depreciation as he had not "been shown to have any engineering qualifications on service lives of companies, depreciation rates." (T. 618-A) The motion was denied. The witness did not testify on service lives—which is an engineering approach to depreciation. The Staff also introduced no evidence on service lives. By way of rebuttal Respondent's Reply Brief pp. 13-14 points out that "the Staff presented no witness qualified on depreciation" and, hence, Respondent's evidence stands uncontradicted. T. 620 through T. 629. See also T. 517 re the importance of obsolescence. Witness Smith who testified on depreciation is an accountant, not an engineer. He does not have any qualification to testify on depreciation. Respondent's Controller in his official position coordinates technical and engineering advice as it affects the accounting on the books and as such is qualified to give the kind of testimony he gave on depreciation.

for the next 25 years on these two units of the plant. Stated in legal language, there is no evidence in contradiction of the showing made by Respondent that 3% is a reasonable rate of depreciation to measure the reasonable cost to serve the Georgia Company. The evidence presented by Respondent is competent, probative, and substantial. It is the only evidence on depreciation of record and is intrinsically persuasive.

Interest Deductions for Income Tax Computations During the 25-Year Contract Period

Witness Smith in Exhibit 45 used the figure of $210,743 for Federal income tax for the year 1956. He furnishes no figures for other years. Respondent shows $593,900 for that year. In Exhibit 44 Witness Smith explains that he is using "Generating Company's own interest deductions in computing its income tax allowance." He argues that "sound cost accounting" requires that. He suggests that anything else is to use "a synthetic tax allowance not consistent with the underlying facts." He accuses the Respondent of substituting "hypothetical interest deductions." However, both his and Respondent's showings for 1956 are only hypothetical estimates. He argues that Respondent's treatment would "rest on the premise or assumption that the Generating Company is no more than a department of the parent company,"—which by the way is exactly correct! Generating Company, as a wholly owned subsidiary, is the parent company's corporate instrumentality to generate this electric energy and makes these sales. Generating Company was created for no other purpose. Witness Smith recognizes the rightness of this when he testifies: "This (system) approach has merit in some instances."

The system is on test here not this "separate corporate entity," not this "contracting and operating entity." To be unfair to the subsidiary is to take money from the parent. Its entitlement or purpose to file separate or consolidated returns in any particular year or years has nothing to do with what the witness himself recognizes as the basic issue, namely, what tax accounting method "would result in the fairest possible distribution of the tax cost consistent with the existing relevant facts."

Because Generating Company was financed on 90% debt ratio, interest deductions are large and tax allowed as expense becomes small. To maintain financial soundness the parent has issued high ratio equity capital and must continue to do so until system capital ratios are near enough the industry averages of capital ratios to assure competitive investor reception of the system securities. As a result the parent (S. C. Company) has less interest to deduct and the Federal income thus computed would be higher. These are undeniable facts. Respondent's witnesses, as outlined above, presented the realities of displaced capital, the effects of higher cost of money upon the parent, and of the abnormal tax burden cast upon the parent by reason of the high-ratio-financing of Generating Company. The only realistic or fair consideration of the tax problem during the 25-year contract period is its treatment on a system basis. Of course it cannot be known now (in 1956) what actual tax returns will be filed in 1978 or 1973 or 1968 or 1963. Nor does the absence of such certainty matter. This Commission is not concerned with whether these system companies pay the correct taxes year by year. This case is concerned with determining whether the charges paid by Georgia Company will compensate fairly the system enterprise in South Carolina which financed and operates the plant which supplies Georgia Company with 75,000 kw of electric energy, and conversely whether those charges exceed the system's cost to serve Georgia Company. To so design accounting elements as to technically satisfy the subsidiary's "costs," while leaving the parent uncompensated for costs directly resulting from creating, financing (with system credit and financial backing), and managing the generating subsidiary is neither moral nor legal, regardless of how regular and routine the accounting procedures are. To use any other than system ratios in computing interest deductions for income tax expense allowances, to use only the subsidiaries interest deductions and ignore the high-debt-financing effects upon the parent company's tax computations would be to measure the fairness here sought by distorted and untrue or half-true facts. Not to take into account the displacement of capital structure of the system caused by the 90% debt-ratio financ-

ing of Generating Company would be grossly unrealistic and unfair in considering whether the charges to Georgia Company over the 25-year period are just and reasonable to compensate for the cost to serve. The cost to serve is not merely the actual operating costs, which Generating Company pays and accounts for, but the capital costs or financing costs, which everyone agrees must be derived from the system capitalization figures. Interest deduction figures must be derived from these system capitalization figures through the 25-year period (as shown in Statement 7 of Exhibit 3); otherwise the South Carolina retail customers of the parent company (South Carolina Electric and Gas Company) will be required to pay additional rates to make up the parent company's additional income taxes attributable to its subnormal interest deductions on its subnormal debt ratio, because it has been compelled by the high debt-ratio of the Generating Company to maintain a counterbalancing higher than normal equity-ratio.

Depreciation Rate for Income Tax Purposes

Exhibit No. 45 uses the rate of 3.25% for depreciation in computing Federal income tax allowance for the year 1956 because it represents the rate claimed by Generating Company and expected "to be allowed by the Internal Revenue Service for statutory purposes". Witness Smith argues that the use of a lower depreciation rate in computing the cost to serve in this case "would return the company an additional profit over and above the fair return." This argument assumes that (1) the Internal Revenue Service will continue to approve 3.25% for the 25-year contract period; and (2) that this Commission will merely follow the Internal Revenue Service determination, although their basis of determination is for tax purposes not as an element of determining whether Respondent's charges to Georgia Company are just and reasonable. Witness Smith furnishes no evidence to support his legalistic argument. Whether the rate of 3.25% for the purpose would produce a fair result during the 25-year period is not even claimed by the witness. The basic fallacy is the assumption that the determination of the Internal Revenue Service will have any particular effect upon the 25-year contract period showing made by

Respondent. Respondent has supported its use of 3% depreciation for the 25-year period. The burden of contravening Respondent's proof has not been met.

Rate Base

Both plant account and working capital were modified by the Staff.

Plant Account

Except for disallowing $60,538 of interest during construction associated with the use of S. C. Company's equity funds, by reducing the interest rate used from 8% to 6%, the Staff accepts the Respondent's figure for Plant Account for 1956, and the allocation of approximately 50% thereof to the two units of Generating Company's plant which is dedicated to the service of Georgia Company.[54] The total initial plant cost of $27,671,900 was used in Respondent's evidence. A working paper introduced in evidence (Ex. No. 28) shows the method of allocating 50% of total plant to gross plant applicable to service to Georgia Company, after eliminating from the allocation the cost of the transmission line to serve Georgia Company, all of which is applicable to Georgia Company service. The initial plant account applicable to service to Georgia Company is shown as $13,861,900 as of the end of 1954 and average plant account from 1957 on to the end of the contract period is shown as $13,706,800. Net plant in 1954 was $13,662,500 and, after deduction of depreciation reserve (accrued annually at the rate of 3% on a straight-line basis), net plant declines to $3,731,000 in 1978.[55] Depreciation reserves applicable to Georgia begin-

[54] The Staff's Exhibit 45 relates only to one year 1956. It accepts Respondent's figure of $13,704,600 as "average plant" for 1956 from Statement 1(d) and deducts one-half of the $60,538 ($30,369) to obtain the "gross average investment" of $13,674,331. The Staff presented no evidence regarding any other year of the 25-year period than 1956. The use of the $13,704,600 constitutes acceptance of the calculations entering into that figure except the one item. The absence of any evidence by the Staff regarding any other year of the 25-year period leaves Respondent's plant investment figures for other years unchallenged by the Staff, except for the item mentioned.

[55] Depreciation calculation is shown on Statement 1(b) (Exhibit 7) for 1954, 1955, 1956, and 1957 and future years as follows: $765,900 (allocated to Georgia $383,800) in 1954; $811,900 (406,800) in 1955; $814,000 (407,800) in 1956; and $814,200 ($407,900) in 1957 and future years. Exhibit 7, statement 1(d).

ning with $7,500 in 1953 and $391,300 in 1954 reaches $10,179,700 in 1978.

Working Capital

Respondent's showing of working capital is challenged (as to the year 1956) by the Staff's proposed modifications affecting natural gas fuel allowance and cash for expenses. In 1956 Respondent shows ⅛ of operating expenses as $191,200. The Staff allowed for that year a minus figure of $97,580, after eliminating natural gas fuel and crediting "tax accrual funds", which Staff alleges represent "68% of allowance for the Federal income tax expenses or the portion thereof available for working capital."[56] The Staff introduced no evidence of these items for any years but 1956. In 1956 the Staff shows working capital of $97,820 and total rate base of $12,855,731, after deductions for all proposed modifications. Respondent shows working capital of $386,600 and total rate base of $13,089,200. Respondent shows $785,400 return at 6%. A 6% return on the Staff's rate base for 1956 would be $771,344 or about $14,000 smaller return.[57] The Staff introduced no evidence as to any of those modifications for any other year than 1956.

In making these estimates Respondent held materials and supplies constant at $195,400 from 1956 until 1978.[58] Unless the dollar is never to be inflated anymore before 1978, that is a very conservative estimate for materials and supplies annually for the next 23 years.

The principle of crediting a proper portion of the tax accruals representing advance payments by customers against the cash component of working capital has been recognized in Commission orders. Whether the amount used by the Staff is correctly computed is not shown by evidence. What the proper amount would be in other years than 1956 is not shown by any Staff evidence. What the effect of that

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[56] Exhibit 45, p. 2 Notes (3) and (4).

[57] Statement 1(c) of Exhibit 7. The Staff also argues for a 5½ rate of return which would produce $707,065 return in 1956—$77,287 less return. But as shown in Table 1, above, the 1956 deficiency of contract revenues measured against a 6% return was $252,000 and against the actual cost of money rate was $200,000.

[58] The Staff adopted the figure in 1956.

modification would be on the 25-year showing cannot be determined from this record.[59]

Rate of Return

A 6% rate of return is demonstrably reasonable in testing the reasonableness of the power charges to the Georgia Company. There is no evidence contra to Respondent's evidence of a 6% rate of return as just and reasonable. The staff presented no evidence in support of its assumed 5½% rate of return. But even considering everything said as though evidence, including material in the staff brief, 6% is established as a reasonable rate of return in this case.

The testimony of Witness Gordon, a partner of Kidder, Peabody and Company, is highly competent evidence, and taken alongside of the statistical financial data furnished by Staff Witness Goubleman is very conservative expert opinion testimony. A rate higher than 6% could be persuasively set forth. On the "actual cost of money basis" of Respondent's showing, the actual cost rate is below 6% in only the two years of 1954 and 1955 (Table I).

If a mathematical approach of arriving at fair return is used (which an experienced financial expert such as Witness Gordon, however, does not use) such as staff counsel used in his brief, the judgment factor is pushed back from the rate of return itself to each of the components. It becomes necessary to judge the correctness of each component, of which there are these six:

(1) System cost of debt (for example 3.46%)
(2) System cost of preferred stock (for example 4.90%)
(3) System cost of common equity (for example 10.3%)
(4) System debt ratio (for example 62.8%)
(5) System preferred stock ratio (for example 9.4%)
(6) System common equity ratio (for example 27.8%)

The examples of cost used were supplied in the brief of staff counsel—in the absence of any testimony by any Staff

[59] There is some question on principle as to the crediting of tax cash beyond the ⅛ cash component. Materials and supplies are not the less required or used in maintaining service because tax accruals are larger than the cash component; but in this proceeding, as will appear below, it is unnecessary to debate substituting a tax accrual cash credit for any part of the material and supplies component of working capital. The logical extension of that tactic would create a negative or minus working capital to be deducted from plant account.

witness as to the component facts to be used to compute a fair rate of return. The system capital ratios used were those testified to by Witness Goubleman as of the end of the year 1954. Had Staff counsel been subjected to cross-examination on his financial opinion, one inquiry would have been made as to why he used end of 1954 system ratios to compute a 1956 test-year rate of return. The system ratios for 1955 were: Debt—62.06%; preferred—8.47%; common—39.47%. Had these ratios been used a higher rate of return would have been produced. The 1956 year end ratios were: Debt—57.93%; preferred—7.52%; common—34.55%. Had the 1956 year end ratios been used the rate of return produced for 1956 would have been 5.6883%.[60]

What fairness requires in this case is the determination of components which are normal for the contract period, not merely ratios occurring in any single year. The 25-year contract period ratios are 50% debt, 15% preferred, and 35% common equity, which Respondent supported by qualified, probative, and uncontradicted expert evidence, including Witness Gordon's uncontested expert financial opinion. Staff Witness Goubleman testified to those approximate normal averages of capitalization ratios, namely, debt 50%; preferred 12%; and common 38%.[61] If these normal average system capitalization ratios, which are supported by uncontradicted expert evidence, were used, the rate of return (using the other components, which Staff counsel argued were just and reasonable) produced would be 7.06%—or 1.06% higher than Respondent claims. Further questions on the use of such components are: why should there be used to test the reasonableness of these charges the historical cost of money of the parent company before the 90% debt-ratio financing occurred to radically affect the investor market reaction to the new and changed system capitalization

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[60] Exhibit 3, Statement 7, p. 1.

[61] Exhibit 19, p. 8 and Exhibit 18, p. 10e showing at end of 1953 for the 25 operating electric utilities: 49.8% debt; 12.5% preferred; 37.7% common. Exhibit 7, Statement 5 shows for the end of 1953 for all Class A and Class B electric utilities; debt—49.83%; preferred—12.77%; common equity—37.40%. Indicating the effect of the 90% debt financing to construct this plant upon system capitalization, it is shown that at the end of 1954 the parent, S. C. Company, had capital ratios of debt—52.64%; preferred—12.35%; common equity—35.01% (Reply Brief, p. 10).

ratios? That is, why should 3.46% be used for this purpose? Would it not be more reasonable to use the cost of debt capital specifically employed to finance this construction, such as cost of debt during the construction period (1952-1954, which is 3.98%, or the cost of all debt financed since 1952 (when this project was begun which is 3.87%. Respondent argues (Reply Brief, p. 13) persuasively that the cost of 3% debt money to the parent in 1950—long before this high-debt-ratio financing was even conceived or could possibly effect the cost of system debt financing—is not appropriately calculated into the system cost of debt to be used as a component of the computation of the rate of return.

It is necessary to conclude that 3.46% is not a fair cost of debt component; but that between 3.50% and 3.75% as testified by Witness Gordon would be fair. It is also necessary to conclude that system ratios at the end of 1954 are not fair and reasonable ratios for this purpose; but that system ratios averaged between those resulting immediately after the 90% debt-ratio financing (such as 62.83% in 1954) and the normalized system ratios calculated to be reached in 1961 (such as 50% debt, 15% preferred and 35% common equity) alone would produce fair and reasonable components for a mathematical computation of a fair rate of return. As Statement 7 shows the 25-year projection of growth capital, it appears that capital ratios such as 1958 of debt 54.7%; preferred 12.53%; common equity 32.77%, or 1959 of debt 52.56%; preferred 13.53%; common equity 33.91% would be the reasonable system ratios to be used for this case.[62] There is no substantial difference between the parties as to what figures to use for the cost of preferred and the cost of common equity.

In this case it is not necessary to compute a specific rate of return to be prescribed, as it must be concluded from all the evidence (including treating staff counsel's proposals as though competent financial expert opinion evidence) that

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[62] Using an average debt cost of 3.625% and the 1958 ratios with the other components—4.9% for preferred and 10.3% for common—would produce a return of 5.98%. To use 1959 capital ratios would produce more than a 6% rate of return.

the showing made by Respondent regarding rate of return is reasonable and must be accepted.[63]

Summary of Conclusions Regarding the Cost to Serve in 1956

Two of the Staff's modifications (so-called) of the Respondent's showing for the year 1956 are accepted, namely, the recomputation of the 12½% of operating expenses, after deducting the natural gas fuel purchased, and crediting 68% allowance for Federal income tax expense against the remaining working capital figures. As shown on Exhibit No. 45 that gives net working capital of $97,920.[64]

The Respondent's average investment of $13,704,600 is accepted, without deduction of 2% of interest capitalized on equity funds, allowing 8% capitalization to stand.

Depreciation reserve as calculated by the Respondent at 3% per year is used in lieu of the $2.75% depreciation figure, included in the Staff's calculation. Total Rate Base is, therefore, $12,800,420 in lieu of $12,855,731 used by the Staff and $13,089,200 used by Respondent. Return at 6% is shown as $768,026 instead of return at 6% of $785,400 as calculated by Respondent or return calculated by the Staff at 5.50% of $707,065, as shown on Exhibit 45. Operation and maintenance are the same for Respondent and Staff. Depreciation of $407,800 at 3% is used as calculated by Respondent in lieu of depreciation of $372,985 as calculated at 2.75% by the Staff. Total cost of service of $3,482,726 is derived instead of $3,500,100 shown on Statement 1 of Exhibit 7 by Respondent or $2,982,040 shown by the Staff in

[63] A study of T. 675 through 685 will demonstrate that both the witness and staff counsel were fully aware of Respondent's three-fold position and its grounds of support, i.e., a straight-line 6% return is reasonably required, a cost of debt capital of about 3.625% is the reasonable cost applicable to the cost to serve Georgia Company, and a system 50% debt ratio, with preferred at 15% and common equity at 35%, should be used for computing the realistic Federal income tax burden on the system during the 25-year period. These are the reasonable system components for determining a fair rate of return. The cross-examination demonstrates that the Staff was well aware of the nature of rebuttal proof that would be required, even though staff counsel suggests otherwise in his motion for leave to file rebuttal brief filed December 21, 1955. Regarding whether surprise could exist, see Exhibit 44, p. 8 where Witness Smith argues against the 50% system debt ratio for tax computation; Exhibit 2, p. 5, Exhibit 7—Statements 1(d) and 2(a); Exhibit 3—Statements 7(b) and 7(c); T. 883-A, 890, 933, and 943. Even this list is not exhaustive.

[64] Respondent does not question either of these.

Exhibit 45. Revenues from the Georgia Company are $3,247,700 as shown on Statement 2 of Exhibit 7. Following the cost classification of Exhibit 45 energy cost of .002844 instead of .0028926 is found. The average cost per kwh of .00746 is found instead of .00750 shown by Respondent on Statement 1 of Exhibit 7. Capacity cost is $28.444 per kw instead of $21.769 calculated by the Staff in Exhibit 45. Average revenue per kwh is .00696 as shown on Statement 2 of Exhibit 7. As shown by Respondent the average cost to serve per kwh reduces annually from .00776 in 1955 (the first full year) to .00527 in 1978; and the revenues likewise reduce from .00709 per kwh in 1955 to .00663 in 1978. In about 1963 revenues for that year at .00681 per kwh will slightly exceed the average cost to serve per kwh which are shown as .00669.

It is not possible from this record to set out the exact annual cost to serve either in dollars or per kwh after reducing working capital, including crediting tax accruals against cash and materials and supplies in determining working capital.

The effect of reducing the rate base from $13,089,200 to $12,800,420 or $288,780 is to reduce the return in 1956 from $785,400 to $768,026 or $17,374. If each return figure shown by Respondent for the other years of the 25-year period is commensurately reduced the remaining cumulative return would not exceed a 6% return on the declining rate base until approximately 1969. From this comparison it is evident that the showing made by Respondent is subject to but very slight reduction and for the purposes of determining the justness and reasonableness of the rates and charges paid by the Georgia Company are substantially accurate. The modification of the method of calculating the working capital and the reduction thereof has but a minor effect upon Respondent's showing of deficiencies of revenues during the first half and more of the 25-year contract period.

The findings and conclusions hereinabove summarized are set forth on Table II below:

TABLE II

Rate Base & Return

	Year 1956	*Source*
Plant:		
Gross Average	$13,704,600	(Stat. 1(d), Exh. 7)
Less: Depreciation	1,002,000	(Stat. 1(d), Exh. 7)
Average net plant	$12,702,600	(Stat. 1(d), Exh. 7)
Working Capital:		
Material and Supplies	$ 195,400	(Stat. 1(d), Exh. 7)
Cash	45,725	Cf. Ex. 45
Credit for tax accruals	(143,305)	Cf. Ex. 45
Net working capital	$ 97,820	
Cost to Serve Georgia Company		
Total Operation and Maintenance	$ 1,529,600	(Stat. 1, Exh. 7)
Depreciation at 3%	407,800	(Stat. 1, Exh. 7)
Taxes: Other than Income	119,500	(Stat. 1, Exh. 7)
Income—State	65,000	(Stat. 1, Exh. 7)
Federal	593,900	(Stat. 1, Exh. 7)
Return	768,026	(Stat. 1, Exh. 7)
Credit for rents	(1,100)	(Stat. 1, Exh. 7)
	$ 3,482,726	
Revenue from Georgia Company	$ 3,247,700	(Stat. 2, Exh. 7)
Average cost per kwh (466,500,000)	$.00746	
Average revenue per kwh (466,500,000)	$.0069665	

FINDINGS AND CONCLUSIONS

Upon the evidentiary record herein and after considering the arguments and contentions of the parties in their briefs,[66] the following further findings of fact and conclusions of law are made:

1. South Carolina Generating Company, Respondent herein, was organized under the laws of South Carolina and financed by South Carolina Electric and Gas Company, as a wholly owned subsidiary, for the purpose of financ-

[65] This table is purely illustrative. The Commission's Order required a showing to be made on a 25-year contract period basis and Respondent made such a showing. Due process requires that rebuttal evidence meet the force of that showing on the entire period—not on any one test year. Proof and decision must not attempt to modify the basis of proof fixed by the Commission.

[66] Rebuttal Brief filed by Commission Staff Counsel on December 21, 1955 and Reply to said Rebuttal Brief filed by Counsel for Respondent on January 16, 1956 have been examined by reason of the public interest, although appropriateness of the Rebuttal Brief is subject to question.

ing, building, owning, and operating the Urquhart steam generating plant near the Savannah River Project of the Atomic Energy Commission (AEC). The parent company desired to contract with the AEC to supply the electric energy requirements of the Hydogen Bomb Plant near the Savannah River within its service territory. To be able to quote rates sufficiently low to compete successfully with public power agencies, such as Santee-Cooper Power Authority and Clarks Hill Dam, for the contract with AEC, for which E. I. duPont de Nemours and Company is agent, it was deemed necessary to create the Generating Company, so that high debt-ratio financing, not possible for the parent company because of restrictions in its indentures, could be used, and, thereby, reduce the operating rates and charges. The testimony of Respondent's witnesses regarding the organization of the Generating Company and the negotiation of the contract with the Georgia Power Company, hereinabove recited, is uncontradicted by any evidence, and is found to be the accurate portrayal of the facts recited. The financing and the favorable interest rates obtained by the Generating Company would not have been possible without the equity invested in the subsidiary, the several guartees and financial commitments, undertaken by the parent company. The lower operating costs obtained by the subsidiary were at the expense of higher financing costs to the parent, in addition to the guarantees and commitments on behalf of the subsidiary undertaken by the parent.

2. Generating Company contracted for the 150,000 kw capacity of its plant by 3 contracts:
   (1) With AEC (duPont agent) for 30,000 kw (Exhibit 12)—the duPont (AEC) contract;
   (2) With parent company for 45,000 kw (Schedule attached to Item A)—the parent company contract;
   (3) With Georgia Power Company for 75,000 kw (Item A)—the Georgia Power contract.

   The evidence regarding these contracts, hereinbefore reviewed, is uncontradicted and is found to be the accurate recital of the facts presented. The presentation of

the facts regarding the contract with the Georgia Power Company by its President, Harllee Branch, Jr., as hereinabove recited, is uncontradicted, and is found to be the accurate portrayal of the facts recited. Specifically the following facts are found regarding the 3 contracts for electric energy:

(a) The duPont (AEC) contract and the parent company contract sell electric energy at lower rates than the Georgia Power contract provides, namely, the energy charge is the same for all but the capacity charges vary as follows:
Georgia Power contract .....$22.50 per kw,
duPont (AEC) contract .....$19.00 per kw,
Parent company contract .....$15.30 per kw.
The charges are subject to the same adjustments in the 3 contracts.

(b) The duPont (AEC) contract provides for guarantees of delivery by parent company, which the Georgia Power contract does not provide; but the Georgia Power contract creates a priority for Georgia Company over the parent company under certain outage conditions. Recitals hereinbefore made regarding these contracts are accurate and are also found to be factual.

(c) The Georgia Power contract gives to the Georgia Company the benefits and advantages recited by the witnesses as hereinbefore set forth, including the testimony of the President of the Georgia Company.

The Georgia Power contract is mutually advantageous to the Georgia Company and its rate payers and to the S. C. Company and its rate payers. There is no evidence on this record that any one or more of the modifications of the Georgia Power contract suggested or recommended on this record would be advantageous to the Georgia Company or its rate payers. The logic of the facts of record is that a reduction of the charges by Generating Company to Georgia Company might with more likelihood bring about a recapture of the 75,000 kw capacity (with this Commission's approval) to the detriment of

Georgia Company and its rate payers than likely to bring any benefit to the Georgia Company and its rate payers. The preponderance of the evidence of record is to the foregoing effect. The evidence is uncontroverted that Georgia Company has obtained and enjoys today for the benefit of its rate payers the cheapest source of 75,000 kw of electric energy available to it, and that it could not in the past, nor can it now, produce the energy at such low cost to it. The evidence is uncontroverted that Georgia Company saves about $600,000 a year by reason of the contract for the 75,000 kw. In 1956 this saving represents almost 80% of the amount of return to Generating Company found hereinabove from the estimates for that year (Table II).

3. The cost to serve the Georgia Company to the S. C. Company and its wholly owned subsidiary is found to exceed the revenues collectible under the Georgia Power contract during the first few years; but to be approximately equal to the revenues during the first half of the term of that contract, including the allowance of a 6% rate of return to Generating Company (which return is for the benefit of the parent company as the sole stockholder). Table II is illustrative of the basis of estimating; but is not determinative of the issues herein on a test year basis. If a test year basis of determination had been ordered (or permitted under the Commission's requirements regarding proof) some other year than 1956 would have been more representative, such as the year 1963. It is further found and concluded that in the last 9 or 10 years of the contract period, after depreciation has reduced the rate base substantially, the rates and charges payable by the Georgia Company may require reexamination as to whether they are higher than the then cost of service.
4. All of the electric energy generated at the Urquhart Plant has substantially the same cost to the S. C. Company, and its subsidiary. It is found, however, that the system cost of energy to AEC is somewhat higher than energy to the Georgia Company by reason of special commitments to duPont regarding protecting deliveries.

In determining whether the system cost of the energy contracted and delivered to Georgia Company and to AEC is repaid by the revenues collectible, the element of fair return is included in cost accounting under regulatory practice. But the cost as within the system (between the subsidiary—Generating Company—and its sole stockholder, the parent company, i. e., the cost of energy used by the parent, is the cost before return, as any profit paid by parent to subsidiary is returnable through dividends back to the parent that paid it. It is, therefore, concluded that the charges payable by Georgia Company under its contract (for example, $22.50 per kw plus energy charges) is not comparable with the charges payable under the contract by the S. C. Company to its subsidiary for the purpose of determining whether there is undue discrimination involved under the Federal Power Act. The system (of parent and subsidiary) is selling and incurring the cost of serving the Georgia Company in every economic reality, regardless of the separate legal entities and bookkeeping techniques. The system is not selling to itself when subsidiary generates energy and delivers it to parent. The charges ($15.30 per kw plus energy charges) paid by parent to subsidiary have any meaning only in the financing and contractual circumstances. They have no economic validity or meaning in determining the true and real cost within the system of the generation and distribution of the energy to the rate payers of the S. C. Company. It is, therefore, found and concluded that the charges payable per contract from parent to subsidiary have no validity, as a matter of fact, as a basis of comparison with contract charges to Georgia Company; and that these two contracts do not present any undue discrimination, or make or grant any undue preference or advantage or subject any person to any undue prejudice or disadvantage, or represent any unreasonable difference in rates, charges, service, facilities, or in any other respect. It is further found and concluded that, insofar as the charges of Generating Company to the parent, S. C. Company, which are within the S. C. Company system, are susceptible of any mean-

ingful comparison with the charges payable by Georgia Company, the special burdens and commitments undertaken by the parent in order to finance the subsidiary and make possible the existence of the 75,000 kw of capacity and the sale and delivery thereof to the Georgia Company, which burdens and commitments have not and cannot be reduced to a definite monetary value, nevertheless, operate to equalize the benefits between Georgia Power Company and its rate payers in the State of Georgia, and the South Carolina Electric and Gas Company and its rate payers in South Carolina; and that the mutuality and mutual benefits envisaged by the officers of both companies and, sincerely sought by them, and to which they unflinchingly testified without any contradiction or contra evidence, removes these contracts from any regulatory criticism under the Federal Power Act. The burden of showing violation has not been met. There is no evidence of any kind suggesting undue discrimination or other violation beyond pointing to the obvious difference in the figures in the contracts. As a matter of fact and law, the differences are reasonable and do not create any undue discrimination, any undue preference or advantage or subject any person to any undue prejudice or disadvantage.

5. The cost to serve AEC under the duPont contract (Exhibit 12) exceeds the revenues collectible under that contract. There is a difference in the capacity charge in the duPont (AEC) contract ($19 per kw) and in the Georgia Power contract ($22.50 per kw). The quality and assurance of delivery of electric energy is higher for AEC than for the Georgia Company. The Georgia Company pays, as hereinbefore, found and concluded, approximately the cost to serve; the duPont Company (AEC) does not pay the cost to serve incurred by the S. C. Company system. AEC is being served at below cost. The Georgia Company is not being served at below cost during the entire contract period. The evidence as to why the S. C. Company system was willing to serve AEC at such a low figure has been recited and as recited is found to be factual. However, it is found and con-

cluded that the difference in the contract charges to Georgia Company does not constitute undue discrimination under the Federal Power Act, nor make nor grant undue preference or advantage to duPont over Georgia Company or its rate payers. Even assuming that under the Federal Power Act this Commission had authority (instead of the South Carolina Public Service Commission) to require Generating Company to require AEC to pay charges commensurate with system costs to serve AEC; neither Georgia Company nor its rate payers (if or as represented by the Georgia Public Service Commission) has any legal standing under the Federal Power Act to demand that this Commission require S. C. Company system to serve Georgia Company at below the cost of service.

6. It has heretofore been found and concluded that Georgia Company will not be paying any excessive rates and charges to Generating Company during the first half of the contract period. There is no legal basis for contending that this Commission has any authority to compel the Respondent to serve Georgia Company below cost for any reason, including the fact that Respondent is serving AEC at below the level of system cost.

7. Whether the reasons for serving AEC as such rates are adequate or not is beyond the issues of this case. Whether the S. C. Company system should render such service to AEC at such rates is not within the jurisdiction of this Commission to determine. The contract in question was negotiated through agencies set up by the Federal Government; but such intrastate retail industrial sale for consumption is not subject to Federal jurisdiction. It is sufficient here to find, and it is found and concluded, that such an interstate utility customer as Georgia Company has no legal standing (nor has it asserted such a position; but rather has supported the present contract) to demand service to it below cost by a South Carolina utility. Merely because the South Carolina utility deemed it sound business to supply an agency of the United States Government within its service area at rates below the system cost of service supplies no moral or legal basis

for requiring Respondent to render service in interstate commerce to a utility in another state at the same below cost rates and charges. Whether Georgia could complain if North Carolina gained such an advantage in interstate commerce is not before us. There is no evidence that any Georgia rate payer is required to pay a single cent more by reason of the low charges to the United States Government agency, AEC. If any rate payers are affected adversely, it would be the South Carolina customers of S. C. Company, not the customers of Georgia Company. But were the recommendations accepted to reduce the charges to Georgia Company because of the lower contract charges to AEC, the South Carolina customers would be required to make up the loss to the S. C. Company system of revenues below its cost to serve, including a reasonable return. Upon this record that would constitute a subsidy to the customers of the Georgia Company at the expense of the customers of South Carolina Electric and Gas Company.

8. It is, therefore, found and concluded that the rates and charges now in force under the contract with Georgia Company are just and reasonable; that they are not unduly discriminatory, make or grant no undue preference or advantage, and subject no person to any undue prejudice or disadvantage. Therefore, the Commission has no present duty or authority to determine some other just and reasonable rate, charge or contract to be thereafter observed between Respondent and Georgia Power Company, and, hence under the Federal Power Act the investigation of Respondent's rates and charges under that Act should be terminated and the proceedings herein dismissed.

ORDER

WHEREFORE, it is ordered, subject to review by the Commission, that:

(A) The investigation of the rates and charges of Respondent, South Carolina Generating Company, be and the same hereby is terminated and that the proceeding initiated by order of the Commission herein

issued October 29, 1954 be and the same hereby is dismissed and terminated.

(B) The motions of Commission Staff Counsel filed December 21, 1955 and of Respondent's Counsel filed January 16, 1956, regarding filing supplementary briefs are granted doubly to assure protecting the public interest.

EMERY J. WOODALL
Presiding Examiner

Filed: February 29, 1956
Issued: March 1, 1956

Before Commissioners: Jerome K. Kuykendall, Chairman; Seaborn L. Digby, Frederick Stueck, William R. Connole and Arthur Kline

In the Matter of
South Carolina Generating Company } Docket No. E-6585

OPINION NO. 297

OPINION AND ORDER REVERSING INITIAL DECISION OF PRESIDING EXAMINER, DETERMINING A JUST AND REASONABLE RATE AND PRESCRIBING THE FILING OF SUPPLEMENTAL RATE SCHEDULE

(Issued October 24, 1956)

This is a rate proceeding arising under Sections 205 and 206 of the Federal Power Act involving the rate for sale of electric energy by South Carolina Generating Company to Georgia Power Company. The electric energy is produced at Generating Company's Plant Urquhart steam generating station near North Augusta, South Carolina, and sold to Georgia Power Company for resale in the State of Georgia. By order issued October 29, 1954, this Commission undertook an investigation to determine whether the contract rate between Generating Company and Georgia Power Com-

pany is unjust, unreasonable, or unduly discriminatory. After hearings held intermittently from April 5, 1955 through July 20, 1955, the Presiding Examiner issued his decision on March 1, 1956, finding the rate to be just and reasonable and not unduly discriminatory. The proceeding is now before us upon exceptions filed by the Georgia Public Service Commission and the Staff of this Commission.[1] We heard oral argument in the matter on May 10, 1956. For the reasons set forth below we find that the contract rate to Georgia Power is unjust and unreasonable, and contrary to the public interest, and hereby reverse the decision of the Presiding Examiner.[2] We further direct the filing of a supplemental rate schedule containing the just and reasonable rate for service to Georgia Power Company, giving effect to our findings and order herein and reducing the rate to Georgia Power Company by $252,186 annually.

Generating Company, a wholly-owned subsidiary of South Carolina Electric & Gas Company (E.&G.Co.), was formed for the purpose of financing the construction of Plant Urquhart steam generating station. It owns and operates the station producing electric energy for sale at wholesale to three customers—E. I. duPont de Nemours & Company (duPont), as prime contractor for the Atomic Energy Commission at Aiken, South Carolina; South Carolina Electric & Gas Company, parent of Generating Company; and Georgia Power Company. Plant Urquhart has a rated capacity of 250,000 KW, made up of two 75,000 KW generators and one 100,000 KW generator.[3] One-half of the output of the two 75,000 KW units is sold through the contract here in question to Georgia Power Company; 30,000 KW is sold to duPont for the Atomic Energy Commission installation; and the remainder is sold to E.&G.Co.

E.&G.Co., which distributes and sells electric energy within the State of South Carolina, at one time considered adding this capacity to its own system instead of setting up

[1] In addition to participation by the Generating Company and the Commission's Staff, the Georgia Public Service Commission and the South Carolina Public Service Commission intervened. The Georgia Commission actively participated in the proceedings, filing a brief and exceptions. A statement of the South Carolina Commission is part of the record.

[2] Because the decision of the Presiding Examiner is at variance with our Opinion herein on most of the major issues involved we set forth our findings and conclusions in full.

[3] The 100,000 kw generator was added to the plant in September, 1955, and has no direct bearing upon these proceedings.

a subsidiary for the purpose.[4] The record shows that during 1950, E.&G.Co. had under study the addition of new generating capacity and was investigating possible sites for location of a steam plant. At that time, it came to the attention of the management of E.&G.Co. that the Atomic Energy Commission planned to locate its Savannah River Plant in the vicinity of Aiken, South Carolina. Sensing the possibility of the addition of a major increase in demand in its market area, E.&G.Co. entered into negotiations with duPont to supply electric energy to the installations at Aiken. Early in the negotiations E.&G.Co. planned to construct the new capacity itself and made an initial offer to duPont based upon that assumption. However, the rate was rejected by duPont as being too high. To meet duPont's objections it was necessary to finance construction at a lower cost than was possible for E.&G.Co. because of the restrictions in the indentures securing the bonds. Therefore, E.&G.Co. formed a wholly-owned subsidiary, the Generating Company, to finance construction of the new capacity, using 90% debt, composed of 75% in mortgage bonds, 15% in 10-year notes and 10% equity represented by common stock taken up by E.&G.Co. The substantial reduction in the cost of financing enabled E.&G.Co., through its instrument, the Generating Company, to offer a rate acceptable to duPont.[5] The location of the duPont load determined the choice of the Plant Urquhart site, approximately 15 miles from Aiken on the Savannah River.

During this period when E.&G.Co. was planning the additional capacity, Georgia Power Company also had under consideration the construction of a steam generating station with a capacity of approximately 66,000 KW. E.&G.Co. having apprised Georgia Power Company of its plans, including the low-cost financing, Georgia Power Company entered into negotiations looking toward the purchase of

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[4] South Carolina Electric & Gas Company has two subsidiaries, South Carolina Generating Company and South Carolina Natural Gas Company. These three companies, considered together, comprise the E.&G. system to which reference is made throughout the Opinion, particularly with respect to capitalization ratios.

[5] The duPont contract was not finally executed until March 9, 1954, after operation of Plant Urquhart had begun.

a substantial block of power on a long-term basis from E.&G.Co. in lieu of building the capacity itself.

Although initially it had been anticipated that duPont might require as much as 250,000 KW, this estimate proved to be far too high, and, as we have indicated, the final contract with duPont involved only 30,000 KW. Thus, Generating Company was in a position to sell 75,000 KW for service to Georgia Power Company on a long-term basis. The negotiations culminated in the contract the terms of which are the subject of this proceeding.

The contract between Generating Company and Georgia Power was executed on November 9, 1951, and was filed with this Commission as Generating Company's FPC Rate Schedule No. 1 on September 21, 1953, to be effective October 2, 1953. The contract provides for the two-part rate consisting of an energy and a capacity charge. The energy charge, about which there is no dispute in this proceeding, is based upon fuel and maintenance costs plus minor taxes not related to income. The capacity charge, as shown by the contract, is made up of a variable basic capacity charge which was estimated at the time of execution of the contract to be $15.30 per KW, and a fixed additional figure of $7.20 per KW. Subject to adjustment in the variable "basic capacity charge" from the time the contract was executed, Georgia Power Company agreed to pay $22.50 per KW over the 25-year contract term. This charge was subject to automatic escalation in the basic capacity charge component to meet actual costs of construction and to take into account certain changes in net plant which might occur over the life of the contract. As a result the capacity charge to Georgia Power Company in 1956 was estimated on the record to be $25.31 which gives effect to an escalation of the basic capacity cost from $15.30 to $18.11.[6]

More specifically, the capacity charge is computed on the following basis:

> The plant cost, including working capital and coal stocks, was estimated at $24,400,000. Annual and fixed charges on this amount were estimated at $1,576,240,

[6] For the purposes of this proceeding we have accepted the classification of costs between the capacity and energy components as proposed by Generating Company and agreed to by the Staff.

which was designed to meet fixed charges for financing, such as interest, amortization, and 8% return on equity capital. These costs resulted in a capacity charge of $10.50 per KW based upon 150,000 KW capacity. To this $10.50 is added another cost component of $4.80 per KW, representing expenses relating to the ownership of Plant Urquhart, including the performance of all corporate, legal, administrative and general functions. The breakdown of these costs is as follows:

Federal, State and local taxes	$460,000
Administrative and general expenses	60,000
Operating, supervision and labor	200,000
Total	$720,000

In contrast to the "basic capacity charge" plus $7.20 per KW applicable to the sale to Georgia Power Company, Generating Company has contracted with its parent, E.&G.Co., for the sale of energy at a capacity charge equal only to the basic capacity charge of $15.30 per KW (escalated to $18.11 for 1956). For the sale to duPont, Generating Company charges $3.70 per KW in addition to the basic capacity charge.[7] In this regard, it is significant that although duPont pays less per KW of capacity than Georgia Power Company, it receives a superior service.

The contract with Georgia Power Company contains an important cancellation provision not provided for in either the contract with duPont or E.&G.Co. The cancellation clause provides that Generating Company may, on 12 months' written notice, reduce the KW contract demand of Georgia Power Company by 25,000 KW. Further, upon 30 months' written notice, Generating Company may reduce the KW contract demand of Georgia Power Company to any extent desired. Additionally, the power delivered to duPont is intended to be continuous, with E.&G.Co. guaranteeing to back-up Generating Company's supply to duPont in case of outages of facilities at Plant Urquhart. Georgia Power Company, however, is entitled only to one-half the output

[7] Since the escalation affected only the basic capacity charge and left the surcharges to duPont and Georgia Power Company untouched, the spread between the rates remains the same.

of the two 75,000 KW units, which could mean that Georgia Power Company would be entitled to no power in case of outages of both the units. Claimed advantages accruing to Georgia Power Company, such as delivery of energy at the high side of the step-up transformer, the record shows are likewise applicable to sales to duPont and to E.&G.Co. It was this obvious difference in treatment that first brought the matter to our attention. However, in view of our finding herein with respect to the just and reasonable rate to be charged for the service to Georgia Power Company we find it unnecessary to pass upon the question of undue discrimination argued by the Staff in its brief.

It is clear from the record that the fixed surcharge of $7.20 per KW (referred to herein as the value-of-service component) assessed against Georgia Power Company approximates one-half the difference between the basic capacity charge and the estimated cost to Georgia Power Company of supplying the same capacity from an alternative source.

In deciding the question of reasonableness of the capacity charge, it is necessary for us to resolve several important issues. The first issue is whether the rate to Georgia Power Company should be based upon cost of service on a net investment rate base or whether the rate should take into account the value of service to Georgia Power Company. If the value-of-service formula as applied to the sale of electric energy is not accepted for the purpose of testing the reasonableness of the rates to Georgia Power Company, other issues which must be resolved in determining the cost of service are (1) the use of the proper test period; (2) the allowance of a reasonable rate of return; (3) allowance for income taxes; (4) the rate of depreciation affecting cost of service and the rate base, and (5) allowances for working capital and interest during construction affecting the rate base. We shall discuss each of these issues in the above-stated order.

Value of Service versus Cost of Service

Generating Company claims that the addition of $7.20 to the basic capacity charge in the rate to Georgia Power Company represents a fair value of the service rendered. In

support of its view, Generating Company argues that the Commission is not bound to the use of any single formula in rate making and urges that the Commission add to the basic capacity "cost" the $7.20 per KW "value" to rate for sales to Georgia Power Company.

There is no doubt that this splitting the difference between "cost" to Generating Company and the estimated cost to Georgia Power Company resulted from arm's length bargaining between buyer and seller and that both buyer and seller claim to be satisfied with the contract. There is also no doubt that approval of a rate based upon recognition of these elements foreign to any cost formula would be a radical departure from established rate-making principles utilized by this Commission in the regulation of public utility rates in the electric industry where there is a clearly ascertainable cost of service.

At this juncture the position of the Georgia Public Service Commission should be noted for it proposes a variant from the usual cost method. It claims that all charges above the basic capacity charge set forth in the contract should be disallowed. It urges that we prescribe a rate to be uniform for the entire term of the contract and suggests the basic capacity charge as the proper rate for the purpose. Such a solution would avoid the necessity of returning to this Commission for adjustments in the rate in case of changed circumstances and would cover all contract costs to the same extent that they are covered by the sale of E.&G.Co. However, we do not feel that we would be justified in accepting it. The rate here involved should be calculated to cover cost on a known plant investment. Without additions to plant, the depreciation reserve will increase and net plant investment will correspondingly decrease over the life of the contract. The decrease in plant investment would, of course, call for a commensurate reduction in rates. But we have no means of measuring today the costs of any net changes in plant which may be made in the future. The solution offered by the Georgia Public Service Commission would be to allow a less than fully compensatory rate during the first portion of the contract term or life of the plant and a more than compensatory rate during the remaining life of the

plant. Based upon the evidence in this record we cannot justify the level rate proposed by the Georgia Public Service Commission. It would result in an unreasonably low rate at one time and an unreasonably high rate at another. Losses incurred because a rate is too low at one time should not be made up in excessive rates in the future. *In the Matters of Atlantic Seaboard Corporation et al.*, Docket Nos. G-1175 and G-1384, Opinion No. 225, issued April 25, 1952; *cf. Bluefield Company v. Public Service Commission*, 262 U.S. 679.

Returning to Generating Company's contention, we wish to make it expressly clear that our decision is based upon a rejection of the application of the value-of-service formula to the rate for the sale of electric energy to Georgia Power Company. Of course, we are not bound to use one formula in our determination. We have heretofore consistently found, with court approval, that the cost-of-service formula is the one best adapted in determining just and reasonable rates in this industry where all costs are known or clearly determinable.

The value-of-service approach advocated by Generating Company would result in a chaotic structure based in part upon the cost to the buyer of supplying substitute power. Such "regulation" would, in fact, be no regulation at all and would completely disregard the public interest and the ultimate consumer which the Act is designed to protect. *Cf. Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672; *Mississippi River Fuel Corp. v. Federal Power Commission*, 121 F. 2d 159 (C.A. 8, 1941).

The decision of the Supreme Court in *Natural Gas Pipeline Co. of America v. Federal Power Commission*, 120 F. 2d 825 (C.A. 7, 1941) reversed on other grounds, 315 U.S. 575, should be dispositive of Generating Company's contention. When the pipeline company urged that rates should be based upon the value of service rendered to the purchaser, the Court held that such an argument ignores "the well-established holdings, backed by reason and experience, to the effect that a fair rate of return, on a fairly established rate base, supplies the correct test of reasonableness. The value

of the service to users is neither a reasonable rate, nor supported by judicial decisions." *Supra,* at p. 633.

The mild prediction by Generating Company that it might exercise the recapture or cancellation provision in its contract unless it is permitted the higher rate only serves to emphasize the importance of our adherence to the cost-of-service test. The manifest purpose of the Act is the regulation of rates for the benefit of the ultimate consumer. Section 201 (a). *Federal Power Commission v. Hope Natural Gas Company,* 320 U.S. 591. If we were to approve the rate contained in the contract solely upon the basis that the two contracting utilities have struck a bargain, and that one of the parties would cancel the contract unless we did approve it, we would be remiss in our duty to protect the ultimate consumer. Such a rationale could lead only to approval of all contract rates irrespective of the public interest involved contrary to the provisions and purposes of the Federal Power Act.[8]

We may also assume that state commissions will play their part to assure that any savings will be passed on to the ultimate consumer. *Federal Power Commission* v. *Interstate Natural Gas Co.,* 336 U. S. 577. That decision is reinforced here by the positive assertion of the Georgia Public Service Commission on this record that it will require the reduction in rate to Georgia Power Company to be passed on to the customers of that utility. We therefore adhere to the cost-of-service test in this proceeding. In view of the contentions here advanced, it is necessary that we remember that in an industry like this fair value is the end product of our determination and not its starting point. *Hope Natural Gas Company* v. *Federal Power Commission,* 320 U. S. 591, 601. To achieve fair value for the electric energy sold to Georgia Power Company we must first determine the cost of service.

There was some intimation by Generating Company that the reasoning upon which the recent decisions in the *Mobile*[9]

[8] If Generating Company should exercise the cancellation provision in its contract, the filing of such a notice of cancellation would afford this Commission an opportunity to determine whether such a change will be consistent with the public interest. *Pennsylvania Water & Power Co. v. Federal Power Commission,* 343 U.S. 414, 422-424.

[9] *United Gas Pipe Line Company v. Mobile Gas Service Corporation,* 350 U.S. 332.

and *Sierra Pacific* [10] cases were decided prevents us from regulating this rate to Georgia Power Company because it is a contract rate. Careful reading of these decisions demonstrates that the contrary conclusion is required. Our investigation and findings herein are precisely the type of regulation which those cases sanction. Further, it is clear that we are required to fix a rate in the public interest, not in the interest of the selling utility alone. Under the circumstances of this case, the public interest would not permit the use of the value-of-service formula as the Generating Company would have us apply it.

The Test Period

In order to determine the just and reasonable rate on a cost-of-service basis it is necessary to use a representative period showing the cost of service. For that purpose we have adopted the calendar year 1956 as shown by the Staff's evidence and testimony. We believe that the test year 1956 accurately portrays the cost of service to Georgia Power Company at the present time and for a reasonable period in the future. It would not be feasible to attempt to use a longer test period such as the 25-year term of the contract used in part and for some purposes by Generating Company and the Presiding Examiner. Costs and conditions over a quarter of a century may change so radically that to base rates of the present day upon estimates of costs and conditions 25 years or even 10 years hence would be to enter to a realm of conjecture and destroy the purpose of a cost-of-service formula.

In prescribing the just and reasonable rate on a cost-of-service formula and using a representative test year we are mindful that our rate jurisdiction is continuing. As changing conditions affect the cost of service to Georgia Power Company we can review the rate here found just and reasonable and prescribe new rates to give effect to the changed costs.

In this regard, we find that the automatic escalation provisions in the contract providing for automatic adjustment of the basic capacity charge for changes in plant investment and expenses (except for a reduction in Federal income tax-

[10] *Federal Power Commission v. Sierra Pacific Power Company*, 350 U.S. 348.

es) are unjust and unreasonable and in contravention of the provisions of the Act and the Commission's Regulations governing the filing of changes in rates by public utilities. Section 205, 16 U.S.C. 824d; Section 35.3 of the Regulations under the Federal Power Act, 18 C.F.R. 35.3. Correspondingly, we find that the contract provision denying both Generating Company and Georgia Power Company the right to seek changes in the rate over the term of the contract is unjust and unreasonable and should be eliminated.

In an effort to substantiate its claim that, even if the value-of-service formula is rejected, the contract rate to Georgia Power Company is just and reasonable, Generating Company presented evidence of its cost of service and its rate base. The Staff did not make a field investigation but, based upon a review of the cost data Generating Company submitted, proposed adjustments both as to rate base and cost-of-service items. Having given careful consideration to the proposals of Generating Company and the suggested adjustments and the evidence of the entire record, we have calculated a total rate base and a cost of service using the 1956 test year as shown in Appendices A and B attached hereto. The net result of these adjustments will be to reduce Generating Company's rate base from $13,089,200 to $12,851,181 and to reduce the total cost of service, including rate of return, from $3,500,100 to $2,995,514. Based upon estimated revenues for 1956, these adjustments will result in a reduction in revenues from $3,247,700 to $2,995,514, or a rate reduction of $252,186 annually. Since the reduction is entirely in the capacity charge, it will reduce the capacity charge in the rate to Generating Company from $25.31 per KW to $21.948 per KW.

Rate of Return

The Generating Company contends for a 6% rate of return upon a rate base of $13,089,200. It would apply this return using hypothetical system debt-equity ratio of 50% debt, 15% preferred stock and 35% common equity. Return for the year 1956 is calculated at $785,400.

We note here that the Presiding Examiner found that the Staff presented no evidence in support of its assumed 5.5% rate of return. The Examiner based his findings upon the

fact that Staff witness did not recommend a specific rate of return although he presented ample facts upon which such a value judgment could be based. Neither we nor the parties were, however, left in doubt as to the Staff's position which it argues in its brief. Nor can any party claim surprise for all the facts were placed on the record. The evidence presented by the Staff in this proceeding is precisely the type of factual evidence which we have consistently used in formulating our judgments which have been upheld in the courts.[11] Significantly, when this same issue was presented on review of our determination in another proceeding, the Court held "We think it sufficient to point out that cost of capital studies such as the one presented to the Commission have withstood judicial review in too many cases for us to reject the one now before us as a proper criterian of rate of return." *Pennsylvania Water & Power Co.* v. *Federal Power Commission,* 193 F. 2d 230, 243 (C.A.D.C., 1951), affirmed 343,U. S. 414.

In contrast, much of the evidence of Generating Company's witness amounts to no more than his conclusions unsupported by adequate factual corroboration. It would not be reasonable to base our judgment as to the fair rate of return wholly upon such opinion evidence. Instead, we reach our judgment upon the facts of record, giving due weight to opinion evidence in the context of those facts. *Market Street Railway Co.* v. *Railroad Commission of California,* 324 U. S. 548, 560. For these reasons we find that the Presiding Examiner erred in his finding that the Staff had presented no rate-of-return evidence. This reaffirms our prior determination made upon an interlocutory motion *In the Matter of Olin Gas Transmission Company,* Docket No. G-8559, issued on April 25, 1956. We find that the record contains ample

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[11] *E.g., Illinois Commerce Commission v. Natural Gas Pipeline Co. of America,* et al., 2 F.P.C. 218, affirmed, 315 U.S. 575; *City of Cleveland v. Hope Natural Gas Company,* 3 F.P.C. 150, affirmed 320 U.S. 591; *Colorado Interstate Gas Company,* Opinion No. 235, issued August 8, 1952, rev'd on other grounds but affirming Commission on rate of return, 209 F. 2d 717 (C.A.1, 1954), rev'd and affirming Commission, 348 U.S. 492. In numerous other instances the Commission has relied upon this type evidence but the determination has not been passed upon by court review. *E.g., United Fuel Gas Company,* Opinion No. 258, issued August 27, 1953; *Michigan-Wisconsin Pipe Line Company,* Opinion No. 275, issued July 30, 1954; *El Paso Natural Gas Company,* Opinion No. 278, issued November 26, 1954.

evidence upon which to base an informed judgment as to the reasonable rate of return.

Upon this evidence we find that a rate of return of 5.55%, based upon the actual debt-equity ratio of the E. & G. Co. system of 62.8%-9.4%-27.8% instead of the 90%-10% ratio of the Generating Company, is just and reasonable.[12] This will allow for service on debt and for dividends on stock. The return compares favorably with similar public utilities with like risks. It is, we believe, ample to maintain credit and attract capital.

The record contains evidence of average interest rates on outstanding bonds of the U. S. Government, industrials, railroads, and utilities, data on the cost of issuance of bonds and stocks by electric operating utilities, earnings-price ratios and yields on common stocks of electric utilities plus detailed evidence with respect to the securities and earnings of E. & G. Co.

In determining the rate of return, Generating Company proposed the use of a hypothetical system capitalization ratio of 50% debt, 15% preferred stock and 35% common equity. In support of its contention it argued that the system credit was essential to the financing of Plant Urquhart, that the system incurred costs because of the high debt ratio of the Generating Company, and that a rate of return should be based upon a 50%-15%-35% capitalization to encourage achievement of that ratio at some future date.

The Staff also proposed the use of system capitalization ratio but advocated the use of the latest actual ratio appearing in the record—62.8% debt, 9.4% preferred stock, and 27.8% common equity. We find the use of this actual ratio to be more truly representative of the facts and to be reasonable. We note that although advantage was gained through the high-debt financing of the separate entity, it is claimed that E. & G. Co. also assumed certain burdens because of the utilization of this corporate device. Among the burdens to E. & G Co., Generating Company lists various commitments which E. & G. Co. made to Generating Company. These commitments, such as the guarantee of pay-

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[12] See Appendix C for a breakdown in the actual capital ratios of the E.&G. system.

ment of commitment fees, the agreement to make up any deficiency in insurance in event Plant Urquhart were destroyed or partially destroyed, and the obligation to the successors or assigns of the Generating Company, are the normal risks which E. & G. Co. would have assumed if it had financed and constructed Plant Urquhart itself. Also to be considered are the effect of the high-debt financing of Generating Company upon the system capitalization ratio causing E. & G. Co. to issue larger amounts of equity, and the importance of the system credit in financing Plant Urquhart. The record does not contain evidence to enable us to attribute a precise value to these factors. However, the use of the actual system capitalization ratio as proposed by the Staff instead of the ratio of Generating Company will automatically give due weight to these factors treating Generating Company, for rate-of-return purposes, as if it were not a separate entity.

We reject use of the hypothetical ratio the achievement of which is no more than a vague goal which E. & G. Co. hopes to reach in 10 to 15 years. Based upon previous financing by E. & G. Co. the record fails to support a conclusion that the goal will, in fact, be reached within the time estimated by E. & G. Co. In any event, the prediction of future capitalization ratios is not a firm foundation for prescribing rates today.

Generating Company's witness gave his opinion that return on debt should be within the range of 3.5% to 3.75%. This opinion was based upon the rates of interest the system companies obtained with allowance also for the prevailing rates of interest and the general outlook. Contrary to consistent Commission precedents, the testimony bears no direct relation to the actual cost to the system of its bond capital.[13] It is but another attempt to inject the concept of replacement cost of debt capital into rate of return when actual cost of debt, coupled with return on equity commensurate with return of other utilities similarly situated, is fair and reasonable. *Safe Harbor Water Power Corp.* v. *Federal Power Commission,* 179 F. 2d 179 (C.A. 3, 1949); *Federal*

[13] Illustrative of the witness' disregard for the actual cost concept is his objection to the Staff's inclusion of the timely refinancing of 4⅛% bonds with 3% in 1950 in its calculation of the cost of debt.

Power Commission v. *Hope Natural Gas Company*, 320 U. S. 591; *Colorado Interstate Gas Company* v. *Federal Power Commission*, 209 F. 2d. 717, (C.A. 10, 1954) *certiorari* denied, 348 U. S. 818.

We find that the present cost of outstanding debt of the system is 3.46%, and that this is the proper allowance for debt in computing the rate of return of Generating Company.[14] It is noteworthy that the stated intention of E. & G. Co. is to reduce the percentage of debt in its system capitalization ratio. Taking cognizance of this aim we may assume that future financing will be primarily through the issuance of equity. In any event, any increases in cost of debt from future financing may be taken into account in fixing rates in the future if such adjustment is warranted.

Likewise, with respect to preferred stock, we find it fair and reasonable to allow only the actual cost. The record shows the average cost to be 4.9%.[15] This allowance is comparable to the average cost of money from new preferred stock issues of electric utilities over a representative period of time. Generating Company's claim for a rate of return on preferred stock of 4.75%, which is premised upon the judgment of Generating Company's witness that preferred stock usually costs about 1% to 1.25% more than bond money, is not reasonable. As we have pointed out above, the witness assumed a cost of bond money based upon factors other than actual cost. If we were to allow only an arbitrary figure of 1% to 1.25% above bond cost for preferred stock, the allowance, starting from a faulty premise, would not be sufficient to cover the actual cost of the preferred to the system. We apply to the allowance for preferred stock the same principle as we apply to bond cost.

Generating Company contends that a rate of return on common equity capital of 10% is needed to assure success of common equity financing. This was based upon the assumption that the market anticipates earnings on equity capital of E. & G. Co. of approximately 9.5% of the net proceeds from financing. To this "barebones cost" Generating Company would add a margin of approximately 0.5%.

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[14] See Appendix D.

[15] See Appendix D.

The Staff, on the other hand, would allow 10.3% on common equity using the actual 27.8% common equity financing of E. & G. Co. system. This is apparently a partially contrived rate proposed so that the over-all rate of return would equal precisely 5.5%. The evidence does show that the earnings-price ratios of E. & G. Co. common equity for the years 1950 through 1954 averaged 7.9%.[16] To this should be added approximately 0.5% to cover financing costs. Further allowance should be made for such other factors considered by investors as the relative thinness of equity, competition from public power, and adverse weather conditions affecting a system with a relatively high percentage of hydro capacity. This margin above the cost of financing also gives appropriate weight to the present upward trend in the money market. The weight to be given to these factors is necessarily a matter of judgment. Giving effect to these factors, we arrive at an allowance of 10.5% on common equity which we find, when using system capitalization ratios, is sufficient in order to assure the maintenance of financial integrity and assure the attraction of capital on favorable terms. *Federal Power Commission* v. *Hope Natural Gas Company,* 320 U. S. 591.

Applying the rates found reasonable for debt, preferred stock, and common equity, and using the system capitalization ratio of 62.8%-9.4%-27.8%, we arrive at an allowance for over-all rate of return of 5.55%.[17] This allowance we find to be ample particularly when the sheltered position of Generating Company is considered and it is noted that Georgia Power and duPont, for all intents and purposes, guarantee payment for 75,000 KW and 30,000 KW of capacity, respectively. The result of our calculation is to reduce the allowance for return to Generating Company from $785,400,

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[16] Also, the four offerings of common stock to the public by E.&G.CO. during the same period were made at net offering-price ratios ranging between 6.37⅛% and 8.1%.

[17]

	% of Total Capital	Rate	Return
Debt	62.8	@ 3.46%	2.17%
Preferred Stock	9.4	@ 4.90%	.46%
Common Equity	27.8	@ 10.50%	2.92%
	100.0		5.55%

based upon a 6% return on a rate base of $13,089,200 to $713,241, based upon a 5.55% return on a rate base of $12,851,181. (See Appendix B.)

Allowance for Income Taxes

As an item of operating expense for the year 1956, Generating Company claims $593,900 as an allowance for Federal income taxes. In computing this amount Generating Company used interest deductions based upon an assumed capitalization of 50% debt and a depreciation rate of 3%. These assumptions would result in an income tax allowance for rate-making purposes which does not correspond to the income taxes actually paid by Generating Company. To that extent the claimed allowance is unreasonable and should be disallowed.[18]

With respect to the deduction of interest payments in computing the income tax allowance, the use of the hypothetical 50% debt proposed by Generating Company would result in a smaller interest deduction and hence a larger tax allowance than if the actual interest is used. We have previously detailed the reasons for finding that the use of the hypothetical 50% debt is unreasonable in this proceeding and pointed out that the use of system capitalization ratios instead of Generating Company's ratios in calculating the allowance for the rate of return to Generating Company gives appropriate weight to the effect of the high-debt financing of Generating Company. With regard to the income tax allowance, Generating Company uses a hypothetical system capitalization ratio instead of its own actual ratio in order to erase the effect of higher tax costs which E. & G. Co. may incur as a result of the heavy debt financing of Generating Company. This is an attempt to enjoy the benefits of the high-debt financing, *i.e.*, the construction of low cost capacity and

[18] In passing, it should be noted that Generating Company, consistent with our previously announced policy concerning the computation of the Income tax allowance, did not reflect a reduction in the tax allowance resulting from the use of accelerated amortization. *In the Matters of Panhandle Eastern Pipe Line Co.* Docket Nos. G-1116, *et al.*, Opinion No. 269, issued April 15, 1954, rev'd on other grounds, 230 F. 2d 810 (C.A.D.C., 1955); *In the Matter of: Treatment of Federal Income Taxes as Affected by Accelerated Amortization*, Docket No. R-126, Opinion Nos. 264, issued December 4, 1953. Neither the Georgia Public Service Commission nor the Staff took exception to this procedure which is not an issue in this proceeding.

the consequent sale to duPont, while making Georgia Power Company and ultimately the consumers in Georgia assume fictitious costs. As such, the allowance proposed by Generating Company is unreasonable.

We have consistently held that the allowance for taxes should not exceed taxes paid. *E.g.*, in the Matters of *Michigan-Wisconsin Pipe Line Company*, Docket Nos. G-1678 and G-1996, Opinion No. 275, issued July 30, 1954. Accordingly, the income tax allowance in this proceeding should be based upon the actual interest deduction of the Generating Company for that is the basis upon which it will pay its taxes.

Similarly with respect to the depreciation rate used in computing the income tax allowance, Generating Company's use of 3% in computing its income tax allowance in its cost of service when it actually uses 3.25% in its tax return would result in a higher tax allowance than the amount actually paid.

We find that interest deductions based upon the actual debt of Generating Company and the depreciation rate of 3.25% in determining the income tax allowance, are just and reasonable. This adjustment will result in a reduction in Generating Company's Federal income tax allowance from $593,900 to $217,434 based upon a 5.55% rate of return as shown in Appendix A attached hereto.

Annual Charge for Depreciation

In computing its annual depreciation expense, Generating Company used a rate of 3%. This is a departure from the 2.75% rate used by E. & G. Co. for many years and represents a switch in its own position during the pendency of these proceedings. While, of course, the change in position might be acceptable if fully justified, Generating Company did not present convincing evidence in support of its newly taken position. Demonstrably, the shift from 2.75% to 3% involves the assumption that the average service life of all plant and equipment abruptly dropped from 36.36 years to 33.33 years. One reason given was that proximity to the Atomic Energy Commission installation at Aiken increased "the hazards of infant mortality." Such a conclusion was not based on any specific study showing a decrease in serv-

ice life but was based upon a "fear of the unknown." However real that fear might be, it is not proper to reflect it in depreciation. *Uniform System of Accounts Prescribed for Public Utilities and Licensees, Definition No. 13.* Investors are compensated for such remote contingencies in the cost of capital and the rate of return.

Due weight should be given to obsolescence and changes in the art. But aside from unsupported opinion testimony, the Generating Company presented no evidence why such factors should increase the depreciation rate here. Significantly, the electric utility industry, which does allow for obsolescence and changes in the art in depreciation rates, has not changed its depreciation rates as Generating Company would do here apparently for the purposes of this proceeding.

We find that the use of a rate of 2.75% in computing the annual charge for depreciation is just and reasonable. This adjustment results in an allowance for depreciation of $372,985 based upon the 1956 test year instead of $407,800 proposed by Generating Company. (See Appendix A.)

Depreciation Reserve

The use of the 2.75% depreciation rate, of course, applies to the computation of the depreciation reserve. The average depreciation reserve, using 2.75% instead of 3%, is reduced from Generating Company's figure of $1,002,000 to $916,420 and the net plant is correspondingly increased by $85,580. (See Appendix B.)

Interest During Construction

Staff proposes to reduce Generating Company's average plant account by $30,269 from $13,704,600 to $13,674,331 to give effect to an allowance of interest on equity funds during construction of 6% per year instead of 8% as proposed by Generating Company. We find that such an adjustment is reasonable and proper and in accord with Electric Plant Instruction No. 5 (paragraph 17) of the *Uniform System of Accounts Prescribed for Public Utilities and Licensees.* Instruction No. 5 provides that, as a component of construction cost properly includible in electric plant accounts, there shall be an allowance for interest during construction including "the net cost of borrowed funds used for construc-

tion purposes and a reasonable rate upon the utility's own funds when so used." E. & G. Co.'s equity funds used for construction purposes should be allowed a reasonable rate. This does not mean that Generating Company should be permitted to capitalize profits on investment before commercial operation of the plant has begun. We find 6% on equity funds used for construction purposes to be reasonable and consistent with our past practice. *E.g., In the Matters of Michigan-Wisconsin Pipe Line Company,* Docket Nos. G-1678 and G-1996, Opinion No. 275, issued July 30, 1954; *In the Matters of Northern Natural Gas Company,* Docket Nos. G-1382, G-1533 and G-1607, Opinion No. 228, issued June 11, 1952, affirmed 206 F. 2d 690 (C.A. 8, 1953).

Working Capital

Generating Company computed working capital for the year 1956 at $386,600, which consists of $195,400 for materials and supplies plus $191,200 representing 12.5% of its annual operating expenses. The Staff adjustment would reduce the total figure by $293,300 to $93,270. This reduction is the result of two corrections. The first would reduce the allowance for operating expenses from $191,200 to $45,725 to eliminate the allowance for the purchase of natural gas. Since Generating Company receives payment from Georgia Power Company before it must pay for natural gas delivered to it for use as fuel at Plant Urquhart, working capital is not needed to cover this operating expense.

The second correction would reduce working capital by $147,855 for Federal income taxes which Generating Company receives in revenues in advance of payment to the Federal Government. The credit amounts to 68% of the allowance for Federal income taxes which is the average amount available to the Generating Company during the test year.

We find both of these adjustments to working capital to be reasonable. Certainly the working capital allowance for rate purposes should not include as operating expenses an amount not needed for that purpose. And, with respect to income tax accruals, we have consistently held that when funds for working capital are supplied by ratepayers and result from the annual lag in income tax payments, the util-

ity has available to it funds which offset capital requirements otherwise to be supplied by investors. To the extent income tax accruals are available from payments by Georgia Power Company, it is inequitable to require it to pay a return upon working capital. *Alabama-Tennessee Natural Gas Company* v. *Federal Power Commission,* 203 F. 2d 494 (C.A. 3, 1953) *Northern Natural Gas Company* v. *Federal Power Commission,* 206 F. 2d 690 (C.A. 8), *certiorari* denied, 346 U. S. 922.

The Commission further *finds*:

(1) South Carolina Generating Company is a wholly-owned sudsidiary of South Carolina Electric & Gas Company (E. & G. Co.) which distributes and sells electric energy wholly within the State of South Carolina. E. & G. Co. also owns all the capital stock of South Carolina Natural Gas Company. For the purposes of this proceeding the two subsidiaries and the parent company, considered together, are termed the Electric & Gas system.

(2) Generating Company owns and operates a steam generating station, known as Plant Urquhart, on the Savannah River, near Beech Island and North Augusta, South Carolina.

(3) Plant Urquhart was originally constructed with two 75,000 KW generating units which were placed in operation in December, 1953 and February, 1954, respectively. A third unit of 100,000 KW was planned to be placed in service in September, 1955 and a fourth unit of 125,000 KW in 1958.

(4) By contract dated November 9, 1951, and on file with this Commission as Generating Company's Rate Schedule FPC No. 1, one-half the capacity of the first two 75,000 KW units at Plant Urquhart is sold to the Georgia Power Company for a contract term of 25 years.

(5) 30,000 KW of capacity from the first two 75,000 KW units is sold to E. I. duPont de Nemours & Company (duPont) for use at the installation of the Atomic Energy Commission at Aiken, South Carolina. The remaining 45,000 KW of capacity from the first two 75,000 KW units is sold to E. & G. Co.

(6) Energy sold to Georgia Power Company is transmitted by Generating Company at 115 kv for a distance of approximately one-half a mile from Plant Urquhart to the Georgia-South Carolina state boundary, where it is delivered to Georgia Power Company which distributes and sells the energy for consumption in Georgia.

(7) The facilities used for the transmission and sale of electric energy to Georgia Power Company, as set forth in paragraph (6) herein, are in addition to and do not include facilities used for the generation of electric energy, facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or facilities for the transmission of electric energy consumed wholly by the transmitter.

(8) The sale of electric energy by Generating Company to Georgia Power Company is a sale of electric energy at wholesale in interstate commerce within the meaning of Sections 201, 205 and 206 of the Federal Power Act.

(9) By reason of ownership and operation of facilities for the transmission and sale of electric energy to Georgia Power Company for resale as set forth in finding (6) herein, Generating Company is a "public utility" within the meaning of Part II of the Federal Power Act.

(10) Pursuant to the terms of the contract between Generating Company and Georgia Power Company electric energy is sold to Georgia Power Company under a two-part rate composed of an energy charge and a capacity charge. The capacity charge is made up of a "basic capacity charge" of $15.30 per KW, adjusted to $18.11 per KW for 1956, and an additional charge of $7.20 per KW. The energy charge is designed to recover fuel, maintenance and minor tax costs.

(11) The $7.20 per KW component in the capacity charge contained in the contract between Generating Company and Georgia Power Company is not related to the cost to Generating Company of rendering the

service but represents a value-of-service component approximately equal to one-half the difference between the "basic capacity charge" of $15.30, as set forth in the contract, and the estimated cost to Georgia Power Company of providing the same capacity itself.

(12) The use of the value-of-service component in the rate to Georgia Power Company is unjust and unreasonable and contrary to the public interest.

(13) Based upon a reasonable test period, the just and reasonable rate to Georgia Power Company should provide revenues sufficient to recover the cost of the service, including a fair return upon the amount prudently invested.

(14) The calendar year 1956 can reasonably be expected to be representative of the immediate future and is suitable for use as a test period in determining the cost of service to Georgia Power Company.

(15) In determining the over-all rate of return of Generating Company allowance of the actual cost to the system of its debt capital of 3.46% and of its preferred stock capital of 4.90% is fair and reasonable.

(16) An allowance of 10.5% for common equity capital of the system provides a sufficient margin in excess of the cost to the system of its common equity capital to assure maintenance of the system's financial integrity and its ability to attract capital on the most favorable terms, and is fair and reasonable.

(17) The over-all cost of capital to the system is properly determined by applying the fair and reasonable rates for debt, preferred stock, and common equity to the actual ratios of the system of 62.8% for debt capital, 9.4% for preferred stock capital, and 27.8% for common equity capital as of December 31, 1954. This application results in an over-all cost of 5.55%.

(18) Based upon the system cost of capital as found above, the allowance of a rate of return of 5.55% to Generating Company is fair and reasonable.

(19) In determining Federal income tax expense, actual interest paid by Generating Company on the basis of

its actual capitalization, and the depreciation rate of 3.25% used by Generating Company in computing its actual income tax should be used.

(20) In determining the annual charge for depreciation in the cost of service, use of the rate of 2.75% instead of the 3% contended for by Generating Company is fair and reasonable.

(21) The amount claimed by Generating Company for net plant should be modified to reflect the use of the 2.75% rate of depreciation found fair and reasonable in (20) above, and by computing interest during construction on equity funds at 6% instead of 8%.

(22) Generating Company's claimed allowance for working capital should be reduced by eliminating expenditures for natural gas from total operating expenses for which cash working capital must be provided, and by crediting working capital with that portion of the cash accrued from income tax receipts for sale of electric energy to Georgia Power Company which is available for use of Generating Company between the dates of receipt and the dates of payment of the tax, amounting to 68% of the allowance for Federal income tax expense.

(23) The annual cost of service to Georgia Power Company, including an allowance for return of 5.55% as found in paragraph (18) determined in accordance with the findings in paragraph (15) through (22) herein, using 1956 as the test year, is $2,995,514. The costs classified to capacity are $1,646,114, or $21,948 per KW.

(24) The present rate to Georgia Power Company based upon the contract between Generating Company and Georgia Power Company would produce revenues of $3,247,700, or $252,186 in excess of the cost of service. Under the classification procedures which we have accepted for the purposes of this proceeding, the excess, amounting to $3.36 per KW, is entirely in the capacity component of the rate.

(25) The capacity component in the present rate for service to Georgia Power Company is in excess of a just and reasonable rate and is unjust and unreasonable.

(26) A rate which will provide revenues equal to the cost of service of $2,995,514, with a capacity component of $21.948 per KW producing revenues equal to the cost of providing the capacity, is just and reasonable.

(27) It is necessary and appropriate to carry out the provisions of the Federal Power Act that Generating Company be required to file changes to its Rate Schedule No. 1 so as to put into effect a capacity rate component of $21.948 per KW without provision for adjustment with respect to changes in plant investment and expenses, but with provision for a reduction therein in the event the Federal income tax rate is lowered, and with a provision allowing either Generating Company or Georgia Power Company to initiate a change in rate in accordance with the provisions of the Act.

Within 30 days of the issuance of this opinion and order Generating Company shall file a supplement to its Rate Schedule FPC No. 1 for service to Georgia Power Company so as to effect the following changes:

(1) The substitution of $21.948 per KW for the present capacity component of the rate and the elimination of all provisions for adjustment thereof, including Sections 3.02 (b), (c), (d) and (e), except that the new capacity component shall be adjusted to reflect any increase or decrease in the Federal Income tax rate upon filing of proper notice of the change pursuant to the Regulations under the Federal Power Act.

(2) The amendment of Section 7.06 so as to permit either Generating Company or Georgia Power Company to initiate a change in the rate in accordance with the provisions of the Federal Power Act.

By the Commission. Commissioner Digby dissenting.

s/ Leon M. Fuquay
Leon M. Fuquay, *Secretary.*

APPENDIX A

Cost of Serviec
Year 1956

Particulars	*Total*	*Cost Classification* *Energy Costs*	*Capacity Costs*
Operation and Maintenance			
Fuel	$1,309,000	$1,309,000	$
Maintenance	33,400	32,900	500
Other	187,200		187,200
Total Operation and Maintenance	$1,529,600	$1,341,900	$ 187,700
Depreciation	$ 372,985	$	$ 372,985
Taxes—Other than Income	119,500	7,500	112,000
Income Taxes:			
Federal	217,434		217,434
State	43,854		43,854
Return at 5.55%	713,241		713,241
Credit for Rents	(1,100)		(1,100)
Total Cost of Service	$2,995,514	$1,349,400	$1,646,114
KWH (000)		466,500	
Energy Cost per KWH		$ .0028926	
Contract Demand—KW			75,000
Cost per KW of Contract Demand			$ 21.948

APPENDIX B

Rate Base and Return
Year 1956

Particulars	*Amount*
Plant:	
Gross Average Investment	$13,674,331
Less: Average Depreciation Reserve	916,420
Average Net Plant Investment	$12,757,911
Working Capital Requirement:	
Material and Supplies	195,400
Cash for expenses	45,725
Credit for tax accrual funds	(147,855)
Net Working Capital Requirement	93,270
Total Rate Base	$12,851,181
Return at 5.55%	$ 713,241

APPENDIX C
SOUTH CAROLINA ELECTRIC & GAS CO. AND SUBSIDIARIES
CAPITALIZATION

December 31, 1954

Issue	*Amount*	*Amount*	*Percent*
Long-Term Debt:			
South Carolina Electric & Gas Co.:			
First and Refunding Mortgage Bonds:			
3% Series, 1980	$ 22,200,000		
3% Series A, 1980	4,000,000		
3¾% Series, 1981	6,000,000		
4⅛% Series, 1983	4,000,000		
3% Series, 1975 (South Carolina Power Co.)	8,000,000		
3% Series, 1977 (South Carolina Power Co.)	4,000,000		
3⅛% Series, 1979 (South Carolina Power Co.)	4,000,000		
Gold Bonds, 5%, 1999 (Charleston Consolidated Railway, Gas and Electric Company)	1,557,000		
Bank Notes, 2½% to 1958	1,762,500		
South Carolina Generating Company:			
First Mtge. Bonds, 3⅞%, 1979	19,878,000		
First Mtge. Bonds, 4%, 1981	4,200,000		
Promissory Notes, 4%, 1964	3,496,000		
South Carolina Natural Gas Co.:			
First Mtge. P. L. Bonds, 3⅞%, 1973	4,000,000		
Total Long-Term Debt		$ 87,093,500	62.8%
Preferred Stock:			
4.50%, $50 par	4,000,000		
4.60%, $50 par	2,765,000		
5%, $50 par	6,261,700		
Total Preferred Stock		13,026,700	9.4%
Common Equity:			
Common Stock, 4.50 par	14,178,577		
Premium on Common	9,539,946		
Earned Surplus	7,245,502		
Capital Surplus	7,527,858		
Total Common Equity		38,491,883	27.8%
Total Capitalization		$138,612,083	100.0%

Source of Data: Prospectus dated 2/24/55 covering 210,053 shares of common stock

APPENDIX D (Revised 5/23/55)

SOUTH CAROLINA ELECTRIC & GAS CO. AND SUBSIDIARIES
COST OF OUTSTANDING DEBT AND PREFERRED STOCK

Issue	Date of Issue	Amount of Issue (000)	Out-standing 12/31/54 (000)	Price to Purchaser (000)	Net Proceeds to Company		Net Cost to Company
					Total (000)	Per Unit	
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
Long-Term Debt							
S. C. Electric & Gas Co.							
1st and Ref. Mtge. Bonds:							
3% Series, 1980[4]	4- 1-50	$22,200	$22,200	$22,866	$22,575	101.69	2.91%
3% Series A, 1980	12- 1-50	4,000	4,000	4,040	4,009	100.22	2.99
3¼% Series, 1981	7- 1-51	6,000	6,000	6,000	5,947	99.12	3.80
4⅛% Series, 1983	12-17-53	4,000	4,000	4,000	3,982	99.56	4.15
3% Series, 1975 (S. C. Power Co.)[4]	1-26-45	8,000	8,000	8,110	7,993	99.92	3.00
3% Series, 1977 (S. C. Power Co.)[4]	5- 1-47	4,000	4,000	4,120	4,054	101.35	2.93
3⅛% Series, 1979 (S. C. Power Co.)	7- 1-49	4,000	4,000	4,000	3,941	98.53	3.20
Gold Bonds, 5%, 1999 (Charleston Consolidated Ry. Gas & Elec. Co.)	3-1-1899	2,500	1,557				5.07[1]
Bank Notes, 2½% to 1958	5-28-48	6,200	1,762	6,200	6,118	98.69	2.76
S. C. Generating Co.:							
First Mtge. Bonds, 3⅞%, 1979	1952-1954	20,000	19,878	20,000	19,836	99.18	3.93
First Mtge. Bonds, 4%, 1981	1954	4,200	4,200	4,200	4,086	97.29	4.17
Promissory Notes, 4%, 1964	1952-1953	4,000	3,496	4,000	3,966	99.14	4.10
S. C. Natural Gas Co.:							
1st Mtge. P. L. Bonds, 3⅞%, 1973	1954	4,000	4,000	4,200	4,155	103.89	3.59[5]
Total Long-Term Debt			$87,093				3.46%
Preferred Stock							
4.50%, $50 par	1954	4,000	4,000	4,000	3,902	48.78	4.61
4.60%, $50 par	10- 3-50	3,000	2,765	3,000	2,907	48.44	4.75
5%, $50 par	1943[2]	6,262	6,262	6,262	[2]	[2]	5.15[3]
Total Preferred Stock			$13,027				4.90%

[1]In the absence of data .07 was added to coupon rate based on cost of other issues.
[2]Issued 1943 in exchange for Pfd. Stock, Bonds and debs.
[3]Expense estimated at .15% based on cost of other issues. This 5% series at end of April 1955 was selling at 53 to yield 4.7%. (Standard & Poor's Stock Guide, May 1955).
[4] 3% Bonds due 1975, 1977 and 1980, which are publicly held, were quoted in April 1955 at 94 to yield 3.21% to maturity. (Standard & Poor's Guide, May 1955).
[5]Disregards $313,443 call premium and expense of refunding $4,000,000 and redeeming $500,000 of 4¾% bonds before consideration of related estimated Federal income tax reduction of $168,000.
Source: Prospectus 2-24-55, Form No. 1, S. E. C. Publications, data furnished by Company.

In the Matter of
South Carolina Generating Company
Docket No. E-6585

PETITION FOR REHEARING

Now comes the South Carolina Generating Company to respectfully petition the Commission to grant a rehearing of the issues presented in this cause and decided by the Commission's Opinion No. 297 of October 24, 1956, for the reasons set out herein.

I.

Under the order of the Commission of October 29, 1954 initiating these proceedings the South Carolina Generating Company was required to show its cost of rendering the service to the Georgia Power Company under the contract in issue here for the year 1954 and for every fifth year thereafter during the twenty-five (25) year life of the contract. This was done and the hearings proceeded on the basis of an investigation of whether the entire contract was unjust or unreasonable. Thus the scope of the hearing as established by the initiating order encompassed the contract in its entirety. The Presiding Examiner made his findings that the rates and charges in the Georgia contract were just, reasonable and non-discriminatory on the basis of the contract, not merely on the basis of the particular year 1956.

The Commission in refusing to follow the Examiner's Report and the Order initiating the investigation failed to consider the entire contract by confining its findings to the Calendar year 1956.

II.

The Commission's Order overrules the decision of the Presiding Examiner on every material issue in the investigation. The findings of the Examiner are amply supported by the evidence of record. Since the Examiner heard all of the witnesses testify, had the benefit of full briefs by all parties and the members of the Commission had no opportunity to hear the witnesses, and only a minority of those deciding this matter the opportunity of hearing oral argument, sound administrative procedure requires that the Commission accept the findings of the Examiner.

III.

Since there is no substantial evidence that the rates and charges to the Georgia Power Company under the contract in issue here are unjust or unreasonable and since the Commission Staff and the Georgia Commission have failed to sustain the burden of proof that these rates and charges were unjust or unreasonable within the meaning of §206, the Commission should have confirmed the Examiner's conclusion that these rates were neither unjust nor unreasonable. *Colorado Interstate Gas Co. vs. Federal Power Comm.* 142 F. 2d. 943, 954.

IV.

The contract of November 9, 1951 between the Generating Company and the Georgia Power Company, under which the former sold and the latter bought 75,000 kw of electrical energy over a twenty-five (25) year period under the terms and conditions contained therein, was an agreement between two unaffiliated electric utilities bargaining at arms length which resulted in mutual benefits to each. By the undisputed testimony in this hearing it permitted the Georgia Power Company to obtain 75,000 kw at a cost of $600,000.00 less per year than it could have obtained such energy from any other source, thus benefiting its customers in Georgia. The terms and conditions of this contract are not subject to modification by this Commission under the doctrine of *Federal Power Commission vs. Sierra Pacific Power Company,* 350 U. S. 348, because there is no showing that the rates and charges under this contract to the Georgia Power Company are so high as to impair "the financial ability" of Georgia "to continue its service, cast upon other consumers an excessive burden or be unduly discriminatory", or otherwise adversely affect the public interest.

V.

The Commission's decision strikes down a fairly negotiated and still mutually satisfactory contract between neighboring electrical utilities providing for joint participation in building and operating additional generating facilities at substantial economies to both utilities, and therefore to the customers of each. The order constitutes a precedent which

will deprive consumers of the benefits of economical cooperation between utilities and which will render more difficult the building of badly needed generating facilities throughout the nation in violation of the spirit of the Federal Power Act.

VI.

In the face of inflationary tendencies over recent decades utility rates have been maintained with no appreciable increase by the increase in plant efficiency, particularly in generating facilities. One of the important factors in the reduction in production costs has been the trend to large and multiple generating units. In turn this increases the advantages of power interchanges between neighboring utilities to effect mass production economies and the maximum utilization of capacity reserves. These economies and these interchanges have been encouraged and are being encouraged by this Commission.

The effect of the order issued here will be to discourage the joint use of facilities. Management cannot be expected to enter into such arrangements if arrangements carefully hammered out on the anvil of arms length negotiations are stricken down though manifestly advantageous to both parties. Investors will hesitate to finance such arrangements as this, and if they do will require higher money costs for arrangements because of the uncertainty of Commission approval, and management knowing that it can recover its entire cost on a cost-to-serve formula will lose much of its incentive to work out joint use of generating facilities with other utilities. The result will be an ultimate increase of the cost to the ultimate consumer and therefore not in the public interest.

VII.

The record shows that under the contract charges the Georgia consumers are substantially benefited. Nevertheless the Commission (p. 8) gives weight to the view that the reduction in annual charges to the Georgia Power Company of some $252,000.00 will be passed on to the consumers of that Company under representations made by the Georgia Public Service Commission, even though no rate proceeding is pending before the Georgia Commission. Such a consideration

is inappropriate in this cause. Respondent can obtain revenues only from Georgia Power Company and Electric & Gas. If the revenues from Georgia Power Company are to be eliminated or substantially reduced, it necessarily follows that an equivalent additional amount will have to be collected by the South Carolina Electric & Gas system from its consumers in South Carolina. There is no showing in this case that an additional rate burden on the South Carolina consumers in order to benefit the consumers in Georgia is justifiable.[1]

VIII.

In its Order the Commission recognizes that it is not bound to follow a "cost to serve" formula. In this case the record conclusively establishes that the contract is a benefit to each utility and to the customers of each. In such circumstances the public interest is not served by an exercise of the power to change the charges. *Arkansas Natural Gas vs. Arkansas Railroad Commission,* 261 U. S. 379, 383.

IX.

The parent company is essentially the vendor to Georgia, negotiating for the sale before Generating Company was incorporated, and shortly thereafter, following assurances from Georgia, firming in the parent's name, the manufacturer's commitment for the second unit at Urquhart Station. The special financing involving a separate indenture and high debt with rapid pay-off, proposed for serving duPont became a practical necessity for prompt financing of a second unit. In order for Generating Company to obtain this necessary debt financing the parent was required to make many significant commitments and guarantees to the security holders and to the Generating Company which included the guarantee of commitment fees, providing excess funds to complete the station, the limited guarantee of the principal and interest on the bonds, the furnishings of funds in excess of insurance to rebuild, to take over any excess capacity, to back

[1] The Georgia Power Company has total assets of approximately $408,000,000, annual operating revenues of $100,000,000, and 560,000 customers. The South Carolina Electric & Gas system has total assets of approximately $170,000,000, annual operating revenues of $41,800,000 and 160,000 customers.

up the duPont contract, and to supplement its payments for power in the event of low revenues. Therefore, these obligations of the parent, although not reflected on the books of Generating Company, should have been considered in determining the cost to serve, but they are not given appropriate consideration in the Commission's order.

X.

The record conclusively shows that because of this 90% debt capitalization of the Generating Company the parent company, during the years of the Urquhart construction (1951-1954), was required to do its own financing for expansion on a high equity ratio, raising during these years 72% of its increase in capital from common equity financing. Because equity money costs much more than debt money (the Commission determines the relative costs at 10.5% for equity and 3.46% for debt, p. 13) and because Federal income taxes are calculated on the income after *interest* on debt but before *dividend* on stock, this displacement of the capital structure of the parent must be considered on the issue of whether the contract rates are reasonable. The Urquhart plant was and could only have been financed on the credit of the parent. The Electric & Gas system is a single economic unit and the impact of the Georgia contract on the system must be considered. The record here permits no other treatment. While the order of the Commission uses the *system* capitalization to determine an appropriate rate of return on the *Generating Company's* properties used to serve this contract, it refuses to adjust the interest deduction of Generating Company and the resulting low Federal income taxes to accord with this system ratio.

XI.

The evidence in this case shows that on a cost to serve basis a rate of return of 6% on the investment in the properties used to serve the Georgia contract is not unjust or unreasonable. This rate of return was supported by the testimony of one of the partners in Kidder, Peabody & Company, one of the largest dealers in electric utility securities, and by the testimony of the financial Vice President of the South Caro-

lina Electric & Gas Company. It is less than the national average return of 6.2% for Class A and B electric utilities as published by the Commission. There is no testimony in the record that such a return is unreasonable or unjust, or that any lower rate of return is reasonable or just. In fact, the evidence shows that the South Carolina Electric & Gas System is a small utility with heavy public power competition, losing bus operations and a high dependence on hydro generation, factors which make a rate above 6% reasonable and just.

XII.

The order of the Commission fails to take into consideration the increase in money costs which have occurred in 1955 and 1956 in the fifteen months period between the date of the closing of testimony in July, 1955 and the date of the order, October, 1956. This increase in money cost is substantial, is available to the Commission from financial publications, and since rates are being made for the future merited consideration. The increase is shown in Exhibit "A" attached hereto, which is a Staff Exhibit 18 brought up to date.

XIII.

The evidence supports the use of a 3% straight line depreciation rate both for tax and expense purposes and the Commission should have approved the use of this rate rather than the use of 2.75% rate for expense and a 3.25% rate for tax purposes, which are not supported by any evidence of probative value.

XIV.

The record shows that the money advanced by the parent to the Generating Company during construction came entirely from equity sources. Since the order provides that a fair return on equity capital is 10.5%, interest during construction should be computed on the basis of at least 8%, as recommended by the Examiner.

XV.

In its order the Commission has computed the South Carolina income tax at a 4.5% rate, whereas the rate is now 5%,

which became effective, as the Commission was advised in the record of the parties, under the provisions of the 1955 Acts (p. 329) as to income tax accounting periods after June 30, 1956. 1952 Code 65-222.

XVI.

In applying the capitalization ratios of the Electric & Gas system for the test year 1956, the Commission used the ratios of December 31, 1954 rather than the later ratios available in the record, as this computation shows:

	Used by FPC (12-31-54)	*Projected* (12-31-55	12-31-56)	*Actual* (12-31-55	9-30-56)
Debt	62.8	62.06	59.51	62.17	58.53
Preferred	9.4	8.47	10.02	8.46	11.31
Common	27.8	29.47	30.47	29.37	30.16

If the reasonableness of the rates and charges are to be determined on the test year 1956, then the capitalization should be computed on the basis of 1956 percentages.

XVII.

The provisions in the contract for automatic adjustment in plant investment and expenses are not unjust or unreasonable and are not in contravention of §205 of the Federal Power Act (16 USCA 824d) or of any valid regulation thereunder. While the order would declare this type of escalation invalid, it recognizes escalation clauses with reference to fuel, maintenance and related taxes. Cf. *in the Matter of: American Louisiana Pipe Line Company,* Docket G-2306 (Order July 20, 1956). Since there is always a "regulatory lag", escalation clauses are important to preserve returns at the proper level. To strike these down means that an additional burden of regulation will be thrown unnecessarily on the staff of this Commission and correspondingly increased operating expenses on the Electric & Gas system incident to the necessity of frequently applying to the Commission for adjustments due to cost changes.

XVIII.

The effect of the order of the Commission is to set aside rates and charges which are neither unjust nor unreasonable

and to establish rates and charges which are neither just nor reasonable, as Exhibit "B" shows.

XIX.

The Commission should have found, as did the Examiner:

8. It is, therefore, found and concluded that the rates and charges now in force under the contract with Georgia Company are just and reasonable; that they are not unduly discriminatory, make or grant no undue preference or advantage, and subject no person to any undue prejudice or disadvantage. Therefore, the Commission has no present duty or authority to determine some other just and reasonable rate, charge or contract to be thereafter observed between Respondent and Georgia Power Company, and, hence under the Federal Power Act the investigation of Respondent's rates and charges under that Act should be terminated and the proceedings herein dismissed.

XX.

For the reasons given by the Presiding Examiner, the direct examination of the witness Knowles Davis should not have been received into evidence or given consideration by the Commission.

All of which is respectfully submitted.

(Sgd.) W. C. McLain

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W. C. McLain

(Sgd.) D. W.Robinson

.....

D. W. Robinson

(Sgd.) Arthur M. Williams, Jr.

.....

Arthur M. Williams, Jr.
Counsel for Respondent, South Carolina Generating Company

Columbia, S. C.
November 21, 1956

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

In the Matter of
South Carolina Generating Company } Docket No. E-6585

EXHIBIT 18 — BROUGHT UP TO DATE

	1955		1956									
	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.
(1b) U. S. Treasury Bonds	2.89	2.88	2.83	2.81	2.93	3.07	2.93	2.94	3.20	3.42	3.43	3.33
(2a) 40 Industrials	3.24	3.28	3.22	3.19	3.27	3.41	3.40	3.39	3.42	3.55	3.68	3.75
(2b) 40 Railroads	3.39	3.45	3.39	3.37	3.37	3.53	3.53	3.56	3.59	3.72	3.83	3.91
(3a) 10 Public Utilities (AAA)	3.15	3.19	3.13	3.09	3.13	3.31	3.30	3.29	3.30	3.44	3.58	3.63
(3b) 10 Public Utilities (AA)	3.20	3.25	3.16	3.12	3.18	3.37	3.34	3.34	3.37	3.48	3.61	3.69
(3c) 10 Public Utilities (A)	3.33	3.36	3.30	3.28	3.28	3.49	3.48	3.49	3.55	3.63	3.72	3.81
(3d) 10 Public Utilities (BAA)	3.49	3.51	3.50	3.50	3.52	3.64	3.62	3.65	3.70	3.84	4.02	4.16

Exhibit B

SOUTH CAROLINA GENERATING COMPANY

Demonstration of Inadequate FPC Allowance for Income Taxes

	FPC Order	FPC, with Income Tax Correction	Revision with Proper Tax Components	Necessary Changes (Col. 3—Col. 1)
Revenues:				
Georgia Power Co.	$2,995,514	$2,995,514	$3,184,924	$ 189,410
Rent Income	1,100	1,100	1,100	
Total Revenues	$2,996,614	$2,996,614	$3,186,024	
Revenue Deductions:				
Operation & Maintenance	$1,529,600	$1,529,600	$1,529,600	
Depreciation	372,985	372,985	372,985	
Taxes—Other than Income	119,500	119,500	119,500	
	$2,022,085	$2,022,085	$2,022,085	
Balance before Inc. Taxes	$ 974,529	$ 974,529	$1,163,939	
State Income Tax @ 4.5%	43,854	43,854	52,377	8,523
Balance before Fed. Inc. Tax	$ 930,675	$ 930,675	$1,111,562	
Federal Income Tax (A)	217,434	303,941	398,002	180,568
Operating Income	$ 713,241	$ 626,734	$ 713,560	
Return per FPC Formula (B)	713,241	713,560	713,560	319
Difference	-0-	$ 86,826	-0-	
(A) Federal Income Tax:				
Bal. before Fed. Inc. Tax	$ 930,675	$ 930,675	$1,111,562	
½% Depreciation Adjustment	66,933	66,933	66,933	
	$ 863,742	$ 863,742	$1,044,629	
Interest Deduction (B)	445,600	279,241	279,241	
Taxable Income	$ 418,142	$ 584,501	$ 765,388	
Federal Inc. Tax @ 52%	217,434	303,941	398,002	
(B) Components of Rate Base:	Ratio	Amount	Rate	Cost
Debt	62.8%	$ 8,070,542	3.46%	$ 279,241
Preferred	9.4%	1,208,011	4.90%	59,193
Common	27.8%	3,572,628	10.50%	375,126
Total	100.0%	$ 12,851,181		
Return per FPC Formula			5.55%	$ 713,560

NOTE

This statement is solely intended to demonstrate the inadequacy of the FPC allowance for income taxes to produce their indicated return on their rate base determination. The use of these basic figures should not be construed as an admission of the adequacy of a 5.55% return or the propriety of their depreciation adjustment in computing Federal income taxes (under existing circumstances) or the 4.5% state income tax rate instead of the actual present 5% rate. For simplification, a further adjustment of the rate base, to reflect changes in the income tax credit in the working fund component, has been ignored.

In the Matter of
South Carolina Generating Company
Docket No. E-6585

PETITION FOR REHEARING

Now comes the South Carolina Public Service Commission, a party in the above captioned proceeding, and respectfully prays the Federal Power Commission to grant a rehearing of the issues presented in this case and decided by that Commission's Opinion and Order issued on the 24th day of October, 1956 and numbered 297, all for the reasons hereinafter set forth.

I

That the Federal Power Commission's Staff has failed to sustain the burden of proof that the rates and charges under consideration are or were unjust or unreasonable within the meaning of §206 of the Federal Power Act, and that there is no substantial evidence in the record that the rates and charges in the contract here in issue were or are unjust or unreasonable within the meaning of the said §206 or in any other manner.

II

That the contract involved in this proceeding was arrived at by arms length bargaining and resulted in an agreement more beneficial to both companies and, through them, more beneficial to their respective consumers, than the contract exists as modified by the Federal Power Commission's Opinion No. 297 as aforesaid, and that such modification is not in the public interest, but is directly opposed thereto in that the contract as changed by the Federal Power Commission's said Opinion No. 297 forces an increased burden on the consumers of the Respondent herein and, at the same time, hastens the day when Respondent will be forced to recall or recapture the electric power and energy in question, which capacity and energy experience and trends indicate that Georgia Power Company will be forced to replace at a greatly increased cost, and that such cost must be ultimately borne by the public it serves.

III

That this contract was arrived at by arms length bargaining between two entirely non-affiliated electric utilities to the mutual benefit of their respective consumers, and that the courts have said that "the purpose of this chapter is to correct abuses of write-ups, inflation of account, and similar practices which have on occasion been found in the utility industry" and there is no evidence in the record to indicate that any of these factors exist here, all of said evidence being, in fact, to the contrary. *Connecticut Light & Power Co. vs. FPC.* 141 F (2nd) 14 (1944). Further, there is no evidence to show that any of such abuses did or do exist and, in fact, the record discloses clearly that none of them—or any other abuse or related practice—did or do exist. Absent such showing, there can be no action by the Federal Power Commission under this section to alter the rates and charges in question.

IV

That the South Carolina Public Service Commission has thoroughly and carefully scrutinized the operations of the Respondent company, including the contract here in issue, *ab initio* and throughout their respective existences, and has found clearly and repeatedly that this contract is in the public interest. This Commission has further found that the action of the Federal Power Commission in ordering a revision of this contract will have a harmful effect upon that portion of the public served by the South Carolina Generating Company and its parent company, and invites the Federal Power Commission's attention to the fact that the purpose of that portion of the Federal Power Act under which this proceeding was initiated and carried out, has been stated by the courts as being one "intended to supplement and not to supersede the regulatory power of the States." *Arkansas Power & Light Co. vs. FPC,* 156 F(2nd) 821 (1946). The South Carolina Public Service Commission respectfully submits to the Federal Power Commission that the Federal Power Commission's actions in this instance completely supersede and disregard the regulatory power of the State of South

Carolina as the same is vested in the South Carolina Public Service Commission, and should therefore be set aside.

V

That the action of the Federal Power Commission in reducing the rates and charges in the contract in issue will be directly harmful to the public interest in that it will severely retard the free contracting between public utilities so necessary to continue to give this country a free flow of power over interconnected transmission systems, and the working out of many arrangements which will decrease the power costs to ultimate consumers. Therefore, the action of the Federal Power Commission herein complained of is beyond its power as the same is vested in it by the Federal Power Act, or any other law or regulation having the force and effect of law.

VI

That the South Carolina Public Service Commission respectfully invites the attention of the Federal Power Commission to the fact that one of the factors looming large in the approval by the South Carolina Public Service Commission of the contract under consideration in this proceeding wherein the South Carolina Generating Company agreed to construct a steam electric generating station and therefrom to export power out of the State of South Carolina to the State of Georgia was the fact that it was beneficial to the public of the State of South Carolina because the said contract contained a stipulation that upon due notice all or a portion of the power thus sold and exported from the State of South Carolina could be recalled and recaptured at will by the vendor. While the question of recall or recapture is not directly in issue in the case at bar, the Federal Power Commission in footnote No. 8 to its Opinion No. 297 herein has indicated that such recall or recapture is within the control of the Federal Power Commission. The South Carolina Public Service Commission respectfully invites the Federal Power Commission's attention to the fact that on the basis of the foregoing stated approval by it of the contract in question

and the statement included in the said footnote No. 8 to Opinion No. 297 the Federal Power Commission is attempting to completely supersede an effective area of regulation and control by the South Carolina Public Service Commission in its protection of the public interest with which it is charged by the statutes of South Carolina, and that such action is contrary to the authorities above cited and repugnant to the Federal constitution.

VII

That the record clearly shows that the parent company of the Respondent assumed many burdens in order to effect what was originally designed as low cost power to be consumed in South Carolina. The Federal Power Commission's action in reducing the rates in question results in giving a benefit to a considerably larger company with somewhat lower rates and placing the resultant greater burden upon the smaller of the two companies whose rates are somewhat higher due to its geographical location in relation to fuel sources, all of which could not by any stretch of the imagination be in the public interest, but would in fact be clearly detrimental to the same.

VIII

That the Federal Power Commission's action in striking down the majority of the escalation clauses is against the public interest in that in its consideration of this contract aforesaid the South Carolina Public Service Commission considered these as an integral part of the contract and its rate. Regulatory lag necessitated by discarding the escalation clauses not only involve a loss of considerable sums before proper increases are granted, but entails considerable additional financial burden in securing such increases, none of which were envisaged by this Commission when it approved the aforesaid agreement. This Commission respectfully invites the attention of the Federal Power Commission to the fact that escalation clauses are a basic and integral factor in modern day business contracts, and that they have been approved by almost all regulatory bodies, and that its action aforesaid not only places an undue burden upon Respondent but will discourage the formulation of similar agreements

in the future, which agreements tend to lower the cost of power and increase the availability thereof in the public interest.

South Carolina Public Service Commission

By Clyde Boland, *Chairman.*

ATTEST:

J. N. LAND, JR., *Secretary*

November 21, 1956

Columbia, South Carolina

Before Commissioners: Jerome K. Kuykendall, *Chairman;* Seaborn L. Digby, Frederick Stueck, William R. Connole and Arthur Kline.

In the Matter of
South Carolina Generating Company
Docket No. E-6585

ORDER DENYING PETITIONS FOR REHEARING

(Issued December 20, 1956)

On November 23, 1956, South Carolina Generating Company, the South Carolina Public Service Commission and the Georgia Public Service Commission filed petitions requesting rehearing of this Commission's opinion No. 297 and order issued October 24, 1956, in this docket. That order directed South Carolina Generating Company to reduce its rates for the sale of electric energy to Georgia Power Company by $252,186 annually. Since, for the most part, the petitions seek to relitigate issues already fully considered, it is appropriate to consider briefly herein only a few of the issues raised by the petitioners.

Generating Company argues that the terms of the contract between it and Georgia Power Company are not subject to modification by the Commission under the doctrine of *Federal Power Commission v. Sierra Pacific Power Company,* 350 U. S. 348, "because there is no showing that the rates and charges . . . are *so high,* as to impair 'the financial ability' of Georgia (Power Company) 'to continue its service, cast upon other consumers an excessive burden or be unduly discriminatory' or otherwise adversely affect the public inter-

est." (Emphasis added.) This argument misinterprets the holding in the *Sierra Pacific* case, *supra,* and apparently would have us entirely disregard the effect of Generating Company's proposed rate-making policy upon ultimate consumers whom the Act is designed to protect. *Cf. Federal Power Commission v. Hope Natural Gas Company,* 320 U. S. 591, 610.

In the *Sierra Pacific* case, the Court was dealing with an entirely different situation from the one confronting us here. In that case, the seller had agreed under contract to a rate lower than its cost of service, including a reasonable rate of return. Later, it attempted unilaterally to increase the rate. "In such circumstances", the Supreme Court held, "the sole concern of the Commission would seem to be whether the rate is so *low* as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." (Emphasis added.) 350 U. S. 348, 355.

In final analysis, this argument of Generating Company is but another aspect of the value-of-service theory which we rejected in opinion No. 297. In its petition the South Carolina Commission also urges acceptance of the value-of-service theory in determining just and reasonable rates. Obviously, if our jurisdiction over contract rates did not attach except under the circumstances proposed by Generating Company, the criteria of a just and reasonable rate would no longer relate to cost of service on a net investment rate base, but would be based upon what the traffic would bear. We reemphasize our finding in opinion No. 297 that the public interest will not permit the use of the value-of-service formula as the Generating Company would have us apply it and we adhere to the cost-of-service approach enunciated in that opinion. The *Sierra Pacific* case does not require otherwise. On this basis, the substantial evidence demonstrates that the contract rate between Generating Company and Georgia Power Company is unjust and unreasonable.

Additionally, Generating Company and the South Carolina Public Service Commission argue that the elimination of escalation provisions affecting the capacity component of the

rate to Georgia Power Company will add to regulatory expense and result in a lag in recovery of costs. Generating Company is protected from changes in fuel costs affecting clause. With regard to the escalation clauses affecting the capacity component, it should be noted that the capacity component of the rate to Georgia Power Company is based upon recovery of capacity costs associated with the output of one-half of the total capacity available from two 75,000 kw generators at Plant Urquhart. Confronted with this relatively stable capacity cost situation, the primary problem is not the recovery of unknown and conjectural increases in capacity costs which might occur, but the maintenance of a just and reasonable rate under conditions of a declining rate base. Under these conditions it is probable that the regulatory lag would work more to the seller's benefit than to its detriment.

Generating Company further requests that the Commission, in its use of the 1956 test year, give effect to a number of changes which have taken place since the close of the record in this proceeding on July 20, 1955. Included among these changes are a purported change in the debt-equity ratio of the South Carolina Electric & Gas System and an increase in the South Carolina state income tax from 4.5% to 5% effective as to income tax accounting periods after June 30, 1956. If we were to reopen the proceedings for the purpose of bringing the record up to date, it would be appropriate to take evidence on all aspects affecting the cost of service to Georgia Power Company. Thus, it might well be determined reasonable to shift from 1956 to 1957 as the test year in determining rates for the future. In this regard, it is clear from Generating Company's evidence now before us that the effect of the declining rate base applicable to sales to Georgia Power Company would outweight the effect of any changes purported to have taken place since the close of the record tending to increase the cost of service. Furthermore, the delay caused by the reopening would, in all probability, result in a lapse of time in which additional changes would occur. Effective regulation and orderly administrative procedure require that there be an end to these proceedings. The rates which we prescribed are based upon the substantial evidence in the record before us. It would not

be in the public interest to prolong these proceedings which have already extended over a period of more than two years. *In the Matters of Michigan-Wisconsin Pipe Line Company,* Docket Nos. G-1678 and G-1996, Opinion No. 275, issued July 30, 1954; *In the Matter of The Ohio Fuel Gas Company,* Docket No. G-2281, order denying rehearing issued August 16, 1956. *Cf. City of Detroit v. Federal Power Commission,* 230 F. 2d 810, 822-823 (CADC, 1955), *certiorari* denied, 352 U. S. 829.

It is urged by the South Carolina Public Service Commission that our order regulating the rate for the sale of electric energy to Georgia Power Company supersedes an effective area of its regulation and control. We think that, clearly, it does not. The rate over which we have exercised our jurisdiction is a rate for the sale of electric energy at wholesale in interstate commerce within the meaning of Sections 201, 205 and 206 of the Federal Power Act and we so found. The wholesale sale to Georgia Power Company is within the category of transactions which Congress intended to regulate. S. Rep. No. 621, 74th Cong., 1st Sess., p. 48 (1935); H. Rep. No. 1138, 74th Cong., 1st Sess., pp. 7-8 (1935). And it was with respect to such wholesale sales that the Supreme Court held the states had no jurisdiction in *Public Utilities Commission v. Attleboro Steam & Electric Company,* 273 U. S. 83 (1927), thus giving rise to the enactment of the Federal Power Act.

In regulating this rate, we must consider the interests of both the producing and the consuming states. This fact is underscored by the active participation in this proceeding by the Georgia Commission representing interests of consumers in Georgia. Notably, the Georgia Commission seeks an even greater reduction in Generating Company's rates than we ordered. It is significant also that the Georgia Commission was prepared to accept our determination if it would have resulted in a prompt resolution of the issues with resulting immediate benefits to the ratepayers of Georgia Power Company. It was only the announced intention of Generating Company to seek rehearing that constrained the Georgia Commission to renew its contention for the lower rates.

The Georgia Commission also urges that we find the contract rate between Generating Company and Georgia Power Company to be unduly discriminatory. Under the circumstances of this case, our finding that the contract rate was unjust and unreasonable and our determination of a just and reasonable rate made it unnecessary to make a formal finding of undue discrimination.

The Commission further finds:

The petitions for rehearing of our opinion No. 297 and accompanying order issued October 24, 1956, set forth no facts and no principles of law which either were not fully considered by the Commission when it adopted the opinion and order or which having now been considered warrant any change in or modification of such opinion and order. All contentions and objections not specifically discussed herein have been considered and found either without basis in law or support in fact but are not sufficiently material to warrant individual treatment or have been adequately disposed of otherwise.

The Commission orders:

The petitions filed on November 23, 1956, by South Carolina Generating Company, the South Carolina Public Service Commission and the Georgia Public Service Commission for rehearing of our opinion No. 297 and accompanying order issued on October 24, 1956, are hereby denied.

By the Commission. Commissioner Digby dissenting.

J. H. GUTRIDE, *Acting Secretary*